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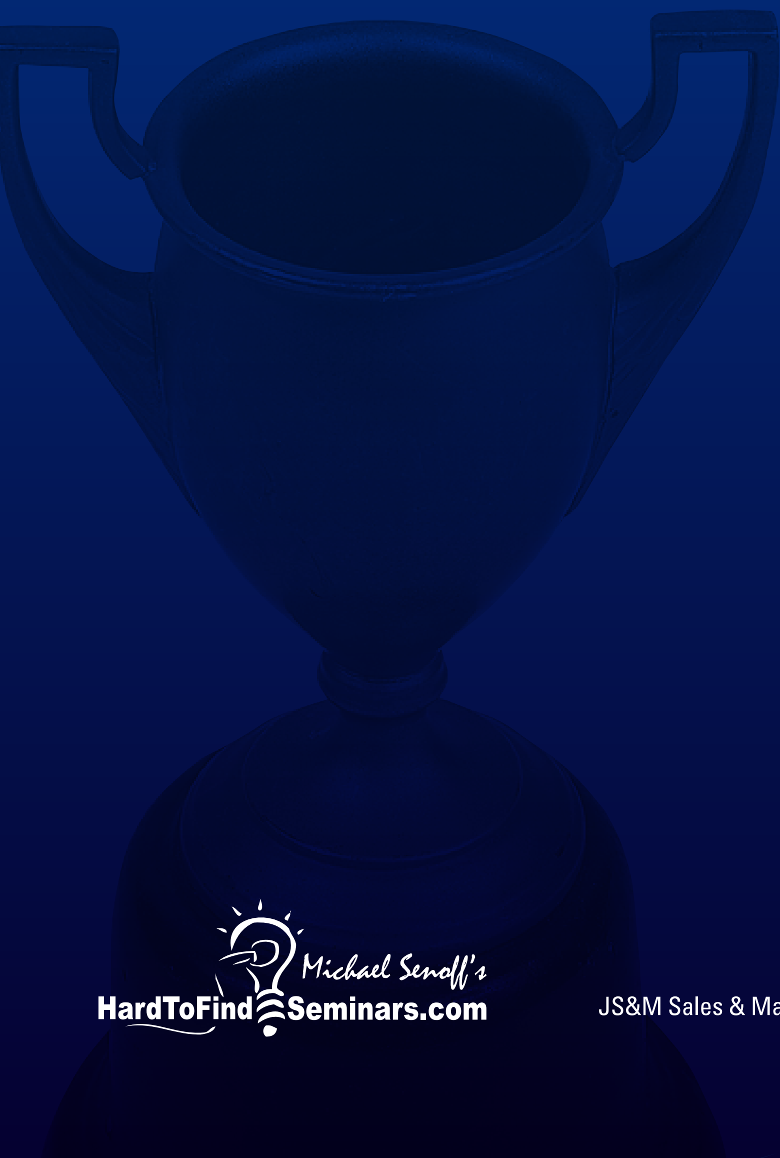

Michael Senoff's HardToFindSeminars.com

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Michael Senoff's
HardToFind Seminars.com

Dear Student,

I'm Michael Senoff, founder and CEO of HardToFindSeminars.com.

For the last five years, I've interviewed the world's best business and marketing minds.

And along the way, I've created a successful home-based publishing business all from my two-car garage.

When my first child was born, he was very sick, and it was then that I knew I had to have a business that I could operate from home.

Now, my challenge is to build the world's largest free resource for online, downloadable audio business interviews.

I knew that I needed a site that contained strategies, solutions, and inside information to help you operate more efficiently

I've learned a lot in the last five years, and today I'm going to show you the skills that you need to survive.

It is my mission, to assist those that are very busy with their careers

And to really make my site different from every other audio content site on the web, I have decided to give you access to this information in a downloadable format.

Now, let's get going.

Michael Senoff

Michael Senoff

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LESSON 1

I take pleasure in introducing to you, Arthur B Hamel, the Dean of American Business. Arthur Hamel is a nationally recognized expert in business opportunities and a well-known author, consultant, investor, business owner, and dynamic lecturer. His expertise is founded on his actual business experience over the past 30 years as well as his formal educational credentials.

Hamel is a doer. Arthur Hamel's early business knowledge came from his years in the trenches. While in his teens, Hamel worked in construction and after earning his degree in industrial engineering from Pennsylvania State University, he applied that knowledge both in working for major industrial giants like IBM and Lockheed as well as in a management consulting firm in which he was a partner HTH Consulting Associates in New York.

Very active today in business management and ownership, Hamel estimates that he has been involved in over 200 business opportunities including formation, ownership, franchising and leasing.

Since 1975, Hamel has also been conducting the Arthur Hamel Business Seminar and has provided thousands of Hamel graduates with valuable, practical business training.

The cassette tape home-study program that you're about to hear will give you the same indepth opportunity to completely familiarize yourself with the total mechanics of business. You will receive easy to follow, step-by-step information on how to select the right business for you, how to analyze it carefully, structure the purchase shrewdly, finance it fully, and own it successfully with substantial cash flow while investing little or no money of your own. You do not have to be a wiz at bookkeeping or math. You do not have to be a college graduate. You do not have to be an experienced business person.

The easy to follow workbook, which has LESSONs to accompany each tape, will provide you with forms and charts to keep and use forever. Here at last is the easy way to learn the proven steps to success. Welcome to the wonderful world of cash flow.

As we start looking into the areas of either buying or starting a business, the thing you have to realize up front is really covered on page 1-1, and what we have is something here that we've had in our program as the introduction, "Don't Be a Quitter", and again I'm not going to read this for you other than say, "Don't be a quitter when the job is tough, or fail in trying with the going is rough." The thing you have to realize when you get involved in business – as you're going out to buying out, as you're going out to start one – it's not going to be that easy. It's going to be probably a lot easier than you think it is.

I've been involved in business now for many, many years. I've also been involved in education of people for over ten, and the key thing we have found, in going back to check on our successful people, is that fact that the people are successful has nothing to do with race, creed, color, sex, national origin – any of those things. It has to do with persistence. It has nothing to do with your IQ level because I don't care if your IQ level is very low or very high. The key thing is persistence because when you go out there to get involved in business and you're getting started whether you're buying an existing one or starting one, a lot of things are going to go wrong. A lot of people are going to put you down. People are going to tell you it doesn't work. People are going to tell you that you couldn't possibly get in business, or just look at you and say, "You? You've got to be kidding."

The thing that always fascinates me as your relatives and friends put you down is be of good cheer because X number of months from now, these same people are going to come back to you and say, "See I told you. I told you you'd succeed." Why because as soon as you start to make money and do well, you're going to find the average person – relative or friend – that put you down before is now going to come back and be your friend. Why? Because you now have beaucoup bucks.

What I want you to consider as you're thinking about section one here is the fact that you're not going to be going to another planet as you get involved business. You're going to have the same problems in life you've had before. The only thing that happens, basically, when you get involved in business is you're going to have more money. Another thing you're going to have to do is figure out ways to enjoy that money because after you get that business, if you let the business bog you done or if you don't have good management or if you've set it up so you're not able to take off and enjoy the money, you're going to find life isn't going to be that sweet because in business it requires two things basically if you want to be happy. Number one, to make the money to cover what you and your family need and also buy all the toys you wants, and the secondary thing that you have is to have good management so you can take off so you can enjoy some of the money.

Also, the thing that you gain with good management is the fact that it may take away a lot of the problems. They're a buffer, and if you get involved in businesses where you don't have that management buffer, you're going to find in most cases you're not going to enjoy the management of a business because you're going to have all those people hitting you all the time.

As you start to consider getting involved in business, three of the basic areas that we're going to talk about on the next page is basically the form of ownership or the form of organization, and as we go through this – this is the only time in this section we're going to cover taxation. So, why don't we go through this now, and I'll just read it and we'll talk about these different areas.

We talk about choosing a form of organization. Starting a business involves among other things, or buying existing ones, a number of substantial tax aspects, and what we have are the most significant tax points you'll encounter.

One of the first decisions is related to the legal form of ownership, and again I'm not an attorney, and you're going to need an attorney to give you advice in all these different areas, but let's start giving an overview as to some of the problems, the good news and bad news you're going to find to get involved in the area.

As you get involved in larger companies, you're going to find the general rule is if you're generally incorporating or buying it or selling up as a form of a corporation because we're going to find we're going to end up with a lot more tax benefits having a corporation, and even though most people think of the basic benefit being the protection, that is also true because you're going to find in a corporation as long as you've done everything properly and you haven't signed personally, you're going to find if something does go wrong with that corporation basically you end up collapsing the problem you have within that corporation and doesn't go out and affect your other assets. Again, I'm generalizing if you just set it up properly.

Also, I'm going to suggest one thing. If you do decide to get involved in the area of forming corporation – again, I'm not an attorney – but, I do want to tell you I run into a number of you that buy these books on how to form a corporation for under X number of dollars in all these Mickey Mouse states, and what I suggest you do is form the corporation in your own state, and what I also suggest you do is get an attorney to do it because then when you run into trouble, you have somebody to go back to.

The thing that really gets me is a lot of you will spend thousands of dollars on your fantastic job in your corporation, setting it up, buying it and the whole thing, and whenever you get down to the corporation part of the form of ownership you screw the thing up by going cheap. Although you may save a hundred or two hundred dollars or three hundred or whatever, the money you've saved you're going to end up losing in the next few years. Why? Because you're going to end up screwing it up. Let the professionals do their job.

Now, again, we've talked about the tax aspects. Let's start talking about the first type here and let's start talking about sole proprietorship. The simplest form of organization is sole proprietorship. It's not an organization at all since it has no existence separate from that of the owner. In fact, an individual may own more than one sole proprietorship and they even elect to use different tax accounting method. Income or loss is reported in a proprietor's income tax return. The proprietor is liable for any self-employment tax on the income, and although most deductions available to other forms of organization are also available to the sole proprietor, certain benefits available to corporate employees such as retirement are medical are restricted.

So, what you're going to find especially when you get involved in businesses making over $50,000 and that's just our general rule of thumb, don't hold us to it, you're going to find that basically with the benefits we have in retirement and other areas, we do like the corporate form of ownership.

The other thing is with a sole proprietorship, it may be a good way to start because basically when you're going out with a sole proprietorship and you don't have a good tax record, the corporation form is not going to protect you legally because even if you have a corporation and you don't have a track record, people are going to ask you to sign personally. So, you end up basically, other than tax wise, back in the same position you would be legally with a sole proprietorship.

The next form of ownership we run into is a thing called a partnership, and a partnership is formed when two or more persons join together and carry on a business, very basic. These persons may be individuals, corporations – yes you can have a partnership between corporations – and other partnerships.

There are two types of partnerships. One is general. One is limited. In general partnerships all partners are jointly and separately liable for all obligations of the partnership. A limited partnership must include at least one general partner who is liable for obligations without limit, and the limited partners are liable only to the extent of their investment and any other obligations they specifically assume. Later on in this program, you're going to find as we get into the area of financing, we'll be talking about a thing called limited partnerships, discussing how we use these in the purchase of businesses, and it works very well.

A partnership does not pay any federal income tax. It computes it's annual taxable income or loss and files a US partnership information return of income. The partnership acts as a conduit reporting items of ordinary income, loss, capital gain and investment interest and investment tax credit to each partner. These items retain their tax character in the partner's hand and must be reported in the partner's tax return where they're subject to the same treatment as though the partner had realized directly.

All elections for income tax purposes with limited exceptions are made by the partnership, and the partners are bound by these elections. Under some circumstances, a partnership may elect not to be treated as such for federal income tax purposes. This exception is available only in cases where income and deductions may be separately computed by each partner.

Now, although it's not necessary to have a formal partnership for tax purposes, it makes good sense to have one. A sound agreement may actually prevent future disputes. And, again, I've been involved in partnerships a number of times. I just want to say basically that we say that partnerships basically don't work. Think about marriage, that's a partnership and we have a lot of divorces today in the country. When you get back to another partnership, the biggest problem is you spend a lot of time building the partnership agreement and how you're going to put it together and what we have found from a person to person standpoint, you don't have a good way out and when problems do come up in a partnership, there's no way to split up the partnership or it's not spelled out enough or it's too restrictive.

So, we usually suggest – again, not from a legal standpoint, but from a practical standpoint – that you consider also the way out and spend a lot of time working on that also.

The main partner into a partnership, and I hate it to put it as basic as this, you're eventually going to get to the point with most of them where you end up accusing them of stealing more money from the company than you're stealing. I know that's very basic, but the thing you want to keep in mind, it is much better in business if you have a great friend to let them go off and buy their business, you buy your business, and then meet every week or so and have lunch and be friends because in most partnerships, you're going to find great friendships turning into hate relationships.

Now, partnerships have several advantages over corporations at start-up. You have operating losses common in new businesses may be deducted against the income of the partners. Funds may generally be withdrawn by the partners without adverse tax consequences. Partnerships are also extremely flexible from a tax standpoint and offer the opportunity to allocate certain items of income or deduction to specific partners with such an allocation with substantial economic affect, and again, we run into this quite often especially in limited partnerships where they're bringing in people in our partnership where we are the general partners, and we're able then to structure the transaction to give our limited partnership not only cash flow, but maybe give them more of the tax benefits that we're getting.

On the other hand, over the long term, partnerships may suffer from some disadvantages. Death or disability of a partner may terminate the partnership. In a general partnership, each partner is jointly and severely liable for their obligations. Partnership interests are usually not freely transferable. Partners like sole proprietors are not eligible for preferential treatment of certain fringe benefits available to people that own corporations.

Of course, from the planning viewpoint there's no reason a business can not begin unincorporated, in other words a sole proprietorship or a general limited partnership and later incorporate when the time is right. Again, you should be talking to your attorney about this.

The last basic general category is use of the corporation, and a corporation unlike a sole proprietorship or a partnership is treated as a person under the law. Since a corporation is preformed under applicable state law and requirements vary, legal assistance is essential. Again, don't go this Mickey Mouse route with these crazy books. Go to an attorney.

Corporations, except so called SubLESSON S described later, are separate tax payers and must compute their taxable income or loss, file a tax return and pay any tax due. Withdrawals of funds from the corporation by the shareholders are subject to income tax. A corporation may select a fiscal year, an accounting method different from those of the shareholders. It's existence is not affected by the death or disability of any shareholder. Corporate stock is usually fully transferable. Stockholders can limit their liability to the amount of their investment in the stock, and offsetting this advantages is an array of Federal and State taxes upon the corporation.

Also to be considered is the potential double taxation of corporate earnings – first at the corporate level and second at the stockholder level where the earnings are paid out, and what they're basically saying here is you know what you're going to do? You're going to end up paying taxes in the corporation on the profit and then on the remainder that you assure as dividends, the people receiving the dividends – the shareholders – are going to end up paying stock also.

A significant exception is SubLESSON S. This is a corporation meeting the requirements of SubLESSON S of the Internal Revenue Code, and the basic thing we want to talk about here, it's the same form as the other forms of incorporation, but what happens is you don't have to pay tax within the corporation and the profits of the corporation actually funnel down through the corporation and the individual shareholders then pay tax as if they were partners in this corporation. In other words, the tax is not provided by the corporation, it's funneled through. You're going to either have to talk to your attorney to find out if you want to use SubLESSON S.

Years ago we found, we didn't use many SubLESSON S corporations because we got a feeling that these were used by people that went out to invest in Mickey Mouse things and weren't looking for a profit. But, we have found recently with changes in the law the government has given us, we have found that SubLESSON S is becoming increasingly important in our planning, and in the last couple of years we've used SubLESSON S a lot more than we ever did in the past.

So, talk to your attorney about it and get some advice, and although you're going to think that maybe you can go out and do some reading on this, I want to tell you something. The money that you spend on taxes with your CPA in this area, and also the money that you spend with your attorney is going to be money well spent. The reason for this is – again, over the years, I've felt, "Ah, let's go the cheap way. Let's not bring in the CPA. Let's not bring in the attorney." I have found in the last few years especially I'll say the last 15 or 20 in business, I found that basically for every dollar that I've spent with a CPAs and I've had many of them that I've worked with, I save five to ten times that amount.

The key thing is, and we're going to talk about this later, it really gets me in the area of taxation because many of you are going to be tempted to go out and cheat on your taxes. You're going to Mickey Mouse your taxes, and I've had a chance to go back and look at a lot of the different businesses that you buy or that you own, and the thing is because you don't go to a CPA or get that professional tax advice, you might find you Mickey Mousing and cheating to pick up another $20 or $30,000 in write-offs that are not legitimate. If you had just gone to a CPA, you probably would've picked-up $70, $80, or $100,000 in legitimate write-offs. So, why don't you spend the money on the legitimate way to go which is a CPA and on the other end, you're going to find that you can actually write-off so much legitimately under our tax laws that you don't have to go out and Mickey Mouse them and play games.

The next area also has to do with an attorney. I'm sure you're going to tell me especially those of you from the Midwest and the Western United States that you don't need an attorney in a transaction. I want to tell you something. Business transactions are very complex. Business transactions right in the beginning that are handled properly by an attorney or going to make life a lot easier and then as your family takes over, your great grandkids take over the company later, you're going to find that you set a good base in that company. Why? Because you did it properly.

So, don't try to go and chince in this area because there's always ways to go out and get this help. Later in the tape program will show you how these professionals will also provide financing for you, but we'll talk about that later.

LESSON 2

We're going to be talking about the search, as we say, the search for the sincere listing. So, turn to page 2-1. I'd like to read you the first paragraph which is very important because whether you're going to be a broker and go out and find businesses to list and sell or if you're going to go out and work as a buyer and buy a business. This is a technique that we recommend for finding business, and although you may have problems in doing this, the problem usually is the approach you're taking.

So, let's review what the approach should be. First of all, the Hamel program is built on using at least five or six different approaches each week. You should spend tow, three, four hours on each approach. If you have more time, go out and do more types of approaches. Do not increase the time on each. What we're saying is stay out of ruts. What we have found over the years, again I do not know exactly why this work and all I can tell you is if you get a lot of ball sin the air instead of finding one or two working, you're going to find they're all going to work.

What most of you do to end up having problems is you go back, you find one technique that works or maybe two techniques, usually only one, and you beat it to death. Then, you come back to me with big tears in your eyes wondering why this doesn't work. Well, you're going to have to realize you're going to have to go out and follow this. You're going to have to have a number of techniques going, and once you get the number of techniques going, you're going to find everybody after a certain period of time will be coming back and bringing business to you.

Again, I want to repeat, stay out of ruts. Do not get hung up on just one thing. The fascinating thing is most of you get hung up going with a source called business brokers, and when you go with business brokers, what most of you end up doing is finding yourself with a lot of problems. That's when you find out that most business brokers are not very good at what they do, and they also end up qualifying you so much that you end up being very disappointed with that approach. So, what I'm saying is if you want to use that approach, fine, but what I'd like you to in addition is go to a number of areas.

Let's start with the number one area – suppliers. The number one source, and suppliers we're talking about, people that supply businesses with goods and services, and I don't know if you realize this or not, but the average business owner when they go to sell, do not call a priest, minister or rabbi. What they normally do is they talk to their supplier because a supplier is a person that's in there everyday or every couple of days talking about their needs or goods and what's happening in the business. When they do get to the point where they want to sell, you're going to find they're going to talk to their supplier.

You're also going to find the average supplier knows who's making $50,000 a year and a $100,000 because it's important to them because they want to make sure that when they're delivering goods and giving these people credit that they get paid.

They also want to know when people sell. Why? They want to make sure they get their money or a guarantee of getting their money before the next owner takes over. So, suppliers have a lot of reasons for doing what they do and they also have good reasons for helping you.

When you go in to talk to a normal supplier – let's use an example. You decide you want to own that fantastic restaurant. Well, tomorrow, if you'd like to, you can go out and hit 10, 15, 20 or 30 restaurants and talk to the different owners, but there's a shortcut. Why not talk to the canned good supplier or the person that supplies that restaurant with meat or liquors or Coca-cola?

What I'm saying is go to that source because you're going to find in one meeting with these people – people called suppliers – you're going to be able to find out about a lot of businesses in the area, and they'll sit down and talk to you about them. You're going to find in addition these people are also going to call you in the future as other businesses become available. So, it's a shortcut, and easy way to go.

Now, for those of you who also have problems in talking to people or maybe have that fear factor, the other thing you have to realize is the average supplier is going to set up an appointment. In other words, they're going to call up so-and-so who happens to be a customer of there's and say, "Hi there, I have this great friend of mine, Art Hamel, and Art Hamel is interested in a business like yours and making $75,000 a year. Are you still interested in selling?" They then set up an appointment and the thing you're going to notice also every supplier will say that you're an old very dear friend. They never say, "Gosh, this bum just walked in off the street." What they normally say is, "I'm sending over a very good friend." So, you're not only finding you're having somebody do the analyzing and selecting for you, but you're also going to find they set up an appointment for you which makes it very easy because you've come recommended.

The next source we talk about here is cold canvassing, and we talk about cold canvassing when we're talking about walking into stores, businesses, it could be manufacturing distributorships, and the thing you have to realize is we're talking about doing each one of these things so many times a week. So, when you get to the point that you're talking about cold canvas, this is where most of you turn off and say, "My gosh, I'm not going to go out. I don't care if it's raining, snowing or whether it's beautiful or bad." That's a fear factor.

The thing I want you to realize in our programs, our regular seminars that we've been teaching now for over ten years, the one reason that we've set up a thing called "Field Trips" in the beginning was not only to educate our students in what was going on in the real world of business, I mean during these seminar periods, but also to get them over the fear factor, and what we have found is by setting out people when they're going through our seminar to visit different businesses, even though they're only out for two hours, three hours whatever it happens to be, we find that it helps almost all of them get over that great fear that they have or that great fantasy they have about business owners being very touch people or hard to talk to, and what they do is they found out just the opposite is true, and can you go out tomorrow and cold canvas? Yes you can, and you're going to find that, let's face it, the average business sells every five years, so on the average one in five should be for sale.

The next category, we're talking about promotion letting the world know. I don't want you ending up becoming closet potential business owners or the same thing with business brokers. You're afraid to go out and let the world know what you're doing. You're embarrassed especially, when you're going out to buy a company. You're afraid that your friends and all the other professionals are going to tell you, "You've got to be kidding. You? You don't have anything. You can't do anything like that." And, you're afraid they're going to put you down so you don't let anybody know.

You're going to find just the opposite is true. If all of your life, you've had been sort of treated like a wimp, you're going to find that the world is going to suddenly look at you differently. Why? Because for the first time in your life, you're going to go out and do something positive, and you're going to be doing something that everyone one of your friends and relatives wanted to do.

So, you're going to find there's going to be a new degree of respect. I'm not going to tell you nobody's ever going to put you down, but it doesn't happen very often. So, let the world know, and what you're going to find is that instead of yourself being the only birddog looking for this great business for you whether you're a broker or a buyer, the thing you're going to find is you're going to have thousands of other people that you know that are also going to call you.

If you don't believe it, in the next couple of days everytime you run into a person, ask them if they know of a business for sale – and I'm talking about friends, relatives, whoever you happen to run into – and you're going to be surprised at the number of people that know about a business that's for sale. It's really fantastic.

The next category, lawyers which is a category many of you end up staying away from – now as I start to go through the different professionals in this section, I don't want you to go out and say, "Hey, I'm going to have to hire an attorney, and the attorney will find a business for me." I don't want you to do that. If you happen to be working with an attorney right now, and the attorney happens to be a friend of yours or maybe the attorney happens to be a person representing you in a case so you know that attorney, what I'd like you to do in the next couple of days is sit down and spend some good time with them. Don't just call him on the phone. Don't try to make up a list of things to send to 50 attorneys in your area. I want you to go out and hit every one of the attorneys that you know. What I'm saying is go out and take your time and get all of them. Just don't shotgun. And, what you're going to find is have breakfast, have lunch with your attorney, spend an hour, an hour and a half, two hours. Spend some good time with that person, male or female, and what you're going to find is that person is going to know about businesses for sale.

Most attorneys either have that through their office because a client has died and they've been asked to help or to sell a business, or they happen to know of one in the office, and if you also let the attorney know that you're willing to pay that person a fee – and again let's restate this point – most of you are going out whether you're working as a broker or a buyer and you're going to be making quite a bit of money on the transaction whether you're buying it or whatever. What you should do now is learn sharing time because a lot of these people whether their friends of yours or professionals working for you, whichever the case may be, they all would like to get paid. In other words, they see you making this big chunk of money all they'd like to say to you is, "Hey friend, why not share part of it?" And, what you're going to have to get down to in every conversation with every professional or friend is show them that you're willing to share. You're willing to pay them a fee even if it's only a finder's fee.

When I start to talk about the next categories, five and six, whether it's CPAs, Accountants or Bookkeepers, the thing that always fascinates me is the fact that most of you come to me and say, "Well, I haven't done that. I haven't gone to people like that." Well, again, let me restate, I don't want you to pick out a CPA out of the Yellow Pages or an accountant or a bookkeeper and sit down and ask them if they have a business for sale. What I want to ask you is, "Are you working with a CPA now or a bookkeeper or accountant?" Do you have friends in these areas?

Again, I'd like you to go out and have breakfast with them, lunch in the next couple of days. Sit down with them, talk to them, and what you're going to find is – again, assuming that the average business sells every five years, and say your CPA or accountant has a hundred clients, out of a hundred clients that means 20 of them are going to be available for sale this year, and although you may not understand this, many clients will go back to their CPAs or accountants or bookkeepers and say, "Will you assist me in selling?" And, you're also going to find, let's face it, who knows which businesses are making $50,000, $100,000, $200,000, who's cheating and who's not cheating, and you're going to find these are the group of people you want to work with. In fact, they're one of the better sources that we work with in the United States.

The next category, stock brokers, is one that a lot of you overlook. And, again, I want to restate what we've mentioned a couple of times on this tape and that is the fact that I don't want you to go out and hire a stockbroker, but if you're working with a stockbroker, the thing you have to realize is stockbrokers handle a lot of transactions because when a sale of stock is included in the transaction, a lot of people will come to their stockbroker and say, "Will you sell my corporation?" Which in essence what they're really doing is selling the stock in that corporation.

So, you find a lot of stockbrokers will have businesses for sale or will know of businesses that are for sale, and if they're not particularly in the business of selling themselves or whatever, you're going to find they'll turn this business over to you, but the thing you have to remember with stockbrokers as all professionals, remember to pay them a fee. They're entitled to a fee, and you are to pay them a fee, and it's also called sharing time. You'll find the stockbrokers then will not only search all the other stockbrokers in their firm at that location, they'll search every other office they have and then when the stockbrokers get together every week or two to have their stockbrokers meetings, you're going to find they're also going to be talking to their friends. Why? By helping you, it's going to be another source of income.

Next category, bankers, is a category many people overlook, and, again, why are bankers aware of the fact that businesses are for sale? Because a lot of clients especially when they're getting loans through their banks will tell their banker. The main reason being they're wondering if the loan is assumable. They're also wondering if the banker might know about some other client that has money that might want to buy their business. So, bankers are going to be a great source also, and it's also nice to get to know your banker because the more you get to know your banker, the easier it's going to be later as you go down and try to get loans. What you're doing now is basically laying the ground work if you haven't done it already, laying that great groundwork that you have to lay with a banker because it's very difficult especially later to go in and hit your banker for a loan when you're in their for the first time. So, it's nice to lay that groundwork and be in their three, four, five, ten times before you finally ask that banker for the loan you're looking for.

The next source, and one of the better sources, or one of the best sources we have found over the years is a thing called The Wall Street Journal. The Wall Street Journal especially in their "For Sale by Owner" business page and also by broker, which is the page that comes out on Wednesday and Thursday in that newspaper, is the best one to get and there's nothing wrong with ordering it Monday through Friday.

The thing you also should realize when you're getting involved with the Wall Street Journal, you're going to find it's broken up by sections. They have broken the United States up in so many sections. So, if you're looking for a business in a certain part of the country or you're selling a business in that area, it's good to advertise in that journal. If you're the type of person that's looking for businesses all over the country, what you might think of doing is getting the Wall Street Journal for each one of the areas of the country.

The other thing you might consider doing also is just going Wednesday and Thursday. For those of you who are anxious and want to go out very fast, why not get it all week, and it does come out Monday through Friday. Again, Wall Street Journal is a fantastic source. The only thin I want to mention though is you contact the Wall Street Journal, there's going to be two different types of ads in the "Business For Sale" section. One is just going to list a phone number and maybe the name of a person, and the other one is going to be box numbers. Again, we've tried a number of these over the years, and we have found when you go after the telephone number type, although it seems to be the easiest and fastest way to go, it's not the best because what's going to happen is the person who's put that ad in there most of the time is going to try to qualify you, and what's going to happen is they don't give you any information and they're trying to pick your brain to find out everything they can from your side. It's always been my policy and philosophy that I, as a buyer or a representative of a buyer, am not going to give any information to the other side until after I basically have a desire or a need.

Let's say you have a great business, fine, but if you don't sell me on it, I have no reason to expect to tell you who I am or what I'm trying to do. So, what we're trying to do is go after usually the box number ads in the Wall Street Journal, and you write to them. We never use company stationary because a lot of the people that are running these ads are going to think you're doing research or you're spying on them. So, what we normally do is use normal stationary. We try to type whenever possible, make them neat, and for those of you who like to save time, do not go to the copy machine and just make out 50 copies and send it to all different people. Myself, when I have run ads in the Wall Street Journal and I've gotten enquiries like this on Xerox paper, I have a tendency to do what most of my friends would which is just throw that in the waste basket.

So, take your time. Go after the ones that look very good, and again send good letters. Again, it might take you a week or two to have these come back, but it's worth it.

Now, don't come back to me and tell me that this doesn't work because even when I'm buying businesses, I not only use the Wall Street Journal, but if you want to take all the other categories I'm talking about. I'm follow this step by step and again, I don't buy businesses every month, but when I do, I go back to the same list, follow the same thing you're doing out here, and I find it works. Incidentally, when the day comes when it doesn't work, then I'm going to change this section.

The next thing, the business opportunity newspapers is a thing I probably get the most questions on, and there's a number of different types, and again, we have looked over the United States and practically every city in the United States has a person or an organization that are putting out "For Sale by Owner" businesses. In other words, people will write in, people will pay a certain fee, and the company is basically advertising for them. They don't collect a commission or a fee. All they're doing is charging for the advertising costs.

I'd love to promote somebody, and I'd love to be able to tell you on this tape or in our programs about the great program available, but to this day, I haven't found that, and I over the years have subscribed to every possible one that they have put out and what we have found in every case, it's either junk, there's not a lot of information, but plain and simple just to sum it up – we have found that we have just wasted our time. Incidentally, if any of you get to the point where you want to make a little extra money and you want to put out something good in this area, we'd love to recommend you.

For those of you that do find somebody in the next few months that may be a good area and if you've used it and reused it, you might recommend it to us and then we can recommend it to other people.

The next area, the trade journals is probably the most overlooked area, and the thing most people do not realize is every category of business has a thing called trade journals. What are trade journals? Those are the journals that are put out by your area. It could be the restaurant industry. It could be the hotel industry. It could be the electronics industry, and every industry has dozens and dozens if not hundreds of magazines. How do you get these magazines? How do you get on their lists? Well, it's very simple, as you're going out to business suppliers or business owners in the different categories, most of them have these books laying all over their desks, and what you can do is just tear out the card, fill it out, and mail it to the people that put out that publication. On almost all of them, they're free as long as you're a part of the industry or about to become part of the industry.

If you don't want to do that and you want to take a shortcut, you can go down to your library to the reference section to the people that put out the standard rate and data books which are the rates for newspapers, rates for television and newspaper advertising, and these same people put out a book also that lists all the publications in the country with an address and you can just go by category which might be carwashes and write to the different publications. Within 45-60 days, you'll be on the mailing lists for many, many people that put out these books.

In the back of these books you're going to find many great businesses for sale. If you want to sell one, it's a great place to sell a specialty business, and for those of you who are looking for management in these specialty management or specialty people, it's a great way to find people because the advertise because they want to get hired. For those who are trying to hire somebody, it's a great place to hire or put an ad in for a manager.

For those of you also that are new getting involved in business, it's great to read these trade journals because you're going to find within every industry there's a number of consulting or industry groups that have consulting people or experts available. Sometimes it's just a part of the service for joining the organization. Other times, you have to pay a little extra for it, but it's very beneficial because those people are specializing only in what you're doing or what you have a problem in.

Real estate brokers, the next category, may not be the number one for you, but for all the years that I've been working, I've found real estate brokers to be my number one source, personally. The reason for this is I still attend a lot of real estate meetings around the country, and although the real estate people at those meetings spend most of their time marketing different pieces of real estate that they have in different parts of the United States, they also usually are sitting on or know about a business for sale, and what I try to do then is talk to them about. Since they know that I specialize or work in business opportunities all the time, what we find is they will then give me a complete package. They may have a listing on it, they may not, but the key thing is I find I pick-up dozens of good businesses every year making quite a bit of cash flow, very well priced, that these better real estate brokers have put together. Again, keep in mind one thing, real estate brokers like to get paid also. So, even though they happen to be very friendly and they'd be very good friends of you, why not tell them about the amount you're going pay if you decide to buy that business or if you're a broker, maybe you're going to do a little co-brokering and give them part of the fee.

You're going to find in this business sharing pays whether you're a broker, whether you're a buyer or seller, by sharing with other people, you're going to actually make more money in business especially when you get away from the greed side.

The next category is the one I have the most fun with and I can't possibly do this on the tape, is a telephone book. The reason's the telephone book is so important is many of you come to me and say, "Gosh, I can't possibly find a business" and it's raining out, or it's snowy, or maybe it's too sunny and you're in an area where you like the rain. Well, the thing you have to realize is we have a thing called the telephone book. We have a thing called the Yellow Pages, and by just going through the Yellow Pages what you're going to find is a number of businesses by category. You want to find suppliers. They're listed in the Yellow Pages. For those of you that want to come to me and tell me there are no businesses available in your town or in your city, why not pick up the Yellow Pages and count the number of businesses that are listed in there keeping in mind every year that number grows by quit a bit, and what you're going to find is you're just making excuses not valid.

The telephone book is very simple because if it happens to be a rainy day or you're trying to pick a category that you're going after, all you have to do is pick out that area, maybe it's something that you always wanted to check into, and what you do is you stick your toe in the water. You start to call these people, ask them if they want to sell.

Now, I know you think you're going to be turned down, you know it's not going to work, but try it. And, what you're going to find is for the hour or two that you spend, a certain number of the people are going to be interested in selling. Incidentally, you're going to find all of them very willing to talk, maybe one or two not, but most of them very willing to talk, and what you're going to find is you can dig out a lot of information, ask if they'd consider selling, and if they want to what you do is you set-up an appointment and you go to see them.

The thing I want to warn you on – on anything whether you're calling on advertisement or you're calling someone on the phone – as soon as you talk to them and they start to give you the story, "Well, I can't really tell you on the phone, you have to come here in person and see it." I just want to give you my experience of doing this for over 30 years, and that is if they don't give you a lot of information on the phone and it's a "Show me" type, you're usually going to find they're trying to explain why they're not doing very well which maybe means that you've wasted your trip. You wasted time going to see them. So, try to get as much information as possible without insulting them.

The next category we have here, directories, and the reason I put directories in number 14 as if I put it up at number one, you'd go to directories and I would never get you to number two or number three. Directories is one of our better sources, our best sources, and the thing you have to realize is one thing as you think about directories. Directories are the things that you find at the library. You go to the reference section and you're going to find in your library you have hundreds if not thousands of these books, and you're going to find state organizations, local organizations, Chamber of Commerce, everyone has put out books in different types of industries, and they have books that lists the names of the owners, the type of the business, how many employees they have. Some of them list what their sales are. Very few that I've seen ever list the profit because it's a very difficult thing to dig out, but the thing is it does give you a feel for how large the company, how long it's been in business, what product line they're in, and what happens is it ends up helping you give you leads.

Now there's two ways to go when you're analyzing directories. Number one, you can go out and write letters. And I want you to keep in mind, if the directory is broken down by category by business, I want to warn you not to mail out anymore than 50 letters because once you mail out 50 letters, you might find that 10 or 15 of them are going to come back and want to sell you their company or they might want you to list it.

The thing that you have to realize, for those of you that are very ambitious and send out 500, you're going to end up with so many people coming back using this approach, you're going to find that you have a basic problem.

Now, when you write this letter, the thing that I want you to do is keep it very simple, don't ask for a lot of information, just ask them for information on it. If you're too specific or make up a list of 50 different things, in most cases you'll kill a deal. What you have to do is get a couple items from the other party, and then each time you talk to them, then you ask for more information. You don't want to kill it by going out and asking for 15 different things the first time. Take it slow. Take your time.

The other thing is on the directories, you can also call because let's say we have written to 50 of them or written to a hundred of them. The other thing you do although you've spent time in your office or in your home calling on the Yellow Pages, this is the next thing is to approach directories and pick areas of the directory and maybe spend an hour or two just calling the different people in there ask them if they're interested in selling, and although a lot of you think that this is not a good way to go and maybe you want to go to the route of looking at newspapers, you're going to find this is more productive than looking at newspapers. In fact, you're going to find the newspaper route which is the way the most of you go is not the correct way. Again, there's nothing wrong with it basically, it's just that it's just not as productive in most areas as the other two things we're talking about here and that becomes very discouraging.

Dun and Bradstreet – Dun and Bradstreet puts out a lot of very good information on businesses, and for those of you who want to spend a few extra dollars, and maybe get additional information which could be ratios, they also give you more as to what their ability is to pay which is also going to give you direction as to how much money they make every day. The D&B ratings are going to give you a lot more information than you're going to get from the directories, and they are expensive compared to what we've been talking about here, but for those of you going out to buy very large companies, you're going to find the amount you're talking about here is insignificant, and if you want to save time or save money, what you might consider doing is you might find a banker or a CPA firm that happens to subscribe to the service that can get you the additional information you need and then the amount becomes a token amount. It may be $50 or $100 or something in that range.

As we look at section 16, the next area, and we start to talk about the Chamber of Commerce, I'd like to restate what we already talked about a number of times in the program, and that is when you get involved and you're going out to find a business, the key thing you have to keep in mind is one technique doesn't work. Again, it's not based on a book I've read or a number of books; this is based on our 37 years experience in business. It's based on our over 10 years experience in teaching seminars, many years over ten years as a matter of fact. The thing you have to realize, we've watched thousands of people every month that go out to find businesses. We then find out what works and what doesn't work. I can tell you flat out for those of you that are going out and still thinking about using just on technique, you're going to find your chance for success very small. You then have a tendency to want to blame the world, blame us for this thing not working, and the key thing is you're doing it wrong. What you have to do is follow the book. What you have to do is follow the method of doing it. If you want to be creative, as I keep telling you, do that later.

One of the things that has happened the last year or so, we have had a number of people that have even organized this area, and again, these are graduates of ours, we haven't done this. This was their idea. The key thing is what they started to do is say, "Let's make this simple. We're going to take these 20 basic techniques…" and keep in mind we're talking about 20 out of 78, okay, why don't we just give you all 78? Because you're going to find that most of you don't even use all 20. You don't need that many. It's overkill. Even 20 is even basically overkill.

When you start to think about going out to find these businesses, what you have to do is keep in mind one thing, it does work. Yes, you will be able to find businesses as long as you don't get in a rut.

Now, one of the easy ways is to leave the program or after you get done studying this is to take the next day, say it's a Monday. Number one you do on Monday. Number two you do on Tuesday. If you find that maybe one day isn't enough to get one thing going, maybe Monday and Tuesday you'll do number one and then number two. You go through all 20, and then by the time you're finished you're going to find that you'll have all sorts of businesses falling out of the tree.

What you do then is you can proceed on the ones that you have or you can keep going and go through the thing all the way through the second time. What we have found in the last couple of years is that if you go through it in that order and do all 20 of them and then go back again, most people don't even have to go back the second time.

If you do have to go back the second time, we normally find we have to check what you have done wrong is you're not following what we're teaching. You picked out one or two and that's what you've concentrated on. And, even though some of them may seem easier, what you have to do is realize one thing. We don't want you going out and try to rely on luck. We don't want you going out and try to stand under a tree. What we want you to do is realize up in that tree there are a lot of businesses available. What you have to do is go out and shake the tree. You can't hope that you're going to luck out because if you're relying on luck, although some of you may make out in that area, what I want you to do is go out and spend some time. If you spend the time, you're going to find you're going to be very successful. No magic, just it's going to work.

Now, we start to talk about the Chamber of Commerce, the thing you have to realize is your local chamber provides essential information about the economic client of the area. The chamber can give you specific facts and figures about business trends, opportunities. They can acquaint you with ownership movement in local industries and businesses. In order to get a realistic view feel of the business community, the Chamber is a must. It's also a great source of well-prepared material to include in your presentation to investors or maybe your family and yourself will be moving to another area. The information is required. They are very nice people to work with. You'll find they'll spend a lot of time with you and they also have a lot of material prepared on the area you live in.

Now, I also suggest if you're moving to another area or you're working with a client moving to another area that you get the Chamber of Commerce package on the area that maybe you or your client are going to move to or you're going to be involved in because it gives you a lot of background information as to what the community's like. It works very well.

The next category, The Better Business Bureau, is one that we've worked with a long time, and although we have them down in 17th position, it's one that could be a little higher. Because the Better Business Bureau is a watchdog of business activities, you can quickly determine how a particular business is being received by the buying public, whether any complaints have been registered, and how they've been resolved. You can also check on the general complaints that are being put forward against all business in that general category by talking to the people at the Better Business Bureau.

The Better Business Bureau is also a great agency to connect yourself within your search for businesses to buy. Get acquainted with the staff, and they often informally share information about businesses in transition. Why are they willing to do this? Because this is part of their job. What you're also going to find this is part of their job being nice to people in business, and again, I suggest that you set up each week a certain amount of time to talk to the Better Business Bureau not only when you're buying or starting your business but also later when you're in business. They're great people to work with.

The next category as you probably already know is the category we have the most trouble with, and again, I have the most trouble with as a person educating. I am a person who has trouble with business brokers when I'm out trying to buy a business, and a couple of weeks ago I had somebody ask me, "What is the number on problem we have in educating people to succeed in business?" And, I always say, "It's business brokers." Why? Because business brokers drive us crazy, and as you're going to find out they do it for a number of reasons.

Some of the reasons are caused by the brokers themselves because the way they act and react and they way they work. And, the other area has to do with we don't understand what business brokers really do. So, let's take the first part even though it's sort of negative.

Before I start, I'd like to have a disclaimer. Although you're going to get a feeling during this section that I think business brokers are probably the lowest thing on earth, you're going to find the public perceives them in this manner. I really don't. What I am trying to tell you is I have a lot of trouble with business brokers, and the reason I have trouble with business brokers is the same reason you do.

Number one, most of the business brokers, and I'm not talking 50% of them. I'm talking about a large number probably about 90%, are totally incompetent. The ones that I have worked with that are not totally incompetent usually are outright dishonest people. They are people that don't know anything about business. They don't care if you get ripped off or not or if they're client even gets ripped off, and you're going to find also, they are people that I consider sleazes of all type areas of businesses.

Now, I also want you to realize taking it from the other side, and again it sounds like I'm saying two different things, but I guess I am. I also can tell you city by city across the United States we have some fantastic business brokers out there also. So, what we have again, like a lot of other areas, we have extremes. We have some cruds out there in the business brokerage area, and then we have some business brokers out there that are the most fantastic people in the world – well-educated, they can do a fantastic job. What you have to do is dig out the good ones. Again, I don't care if you're talking about attorneys, CPAs or whatever, you're going to find some good and some bad. We have a cross-section of people in all the basic areas.

Now, as you're thinking about a business broker, keep in mind one thing, many of you try to go out and finance businesses 100% or close to 100%, and again, there's nothing wrong with that because keep in mind we're doing one thing – if you're going out to finance a business 100%, what we've been educating you in or about, is the fact that you can do this if the business does what? If the business is priced right and it has good financing. If after the financing you still have enough money left over to feed your family or your client's family. Then also cover the different problems you're going to have in business or you build in a safety factor.

Now, when you're dealing with a business broker, you have to realize, most business brokers do not represent you the buyer if you happen to be the buyer. If you happen to be the seller, a lot of times you're the one being represented. But, the problem is if the broker were representing the seller, and having a contract with the seller to protect that seller, a lot of people get irritated.

Now, if the attorney and CPA representing the seller were to put you down as a buyer, you wouldn't think much of it because the are agents for the other side, but the thing that gets me which is a double standard basically, why can't business brokers do the same thing? They have the same type of agency set-up. They're being paid by the other party, and the other party has said to them, "Look, I've tried to sell the business myself, but the reason I'm hiring a business broker is I want the business broker to screen all the buyers coming in. I don't want 8,000 people coming in every hour. It drives me nuts. I want you to find out who can perform."

Now, most business brokers today are trained to do one thing if they're very good and that is to screen people. Now, they don't base it on your desire or your ability to put the transaction together. They would like to see a financial statement or some sort of credentials that show them you have the down payment, that you have the working capital, and all the other requirements you have to have to buy that certain business.

If brokers don't do this taking it from their side, the average business broker spends all their time driving everybody all over town showing them businesses especially on those days when there's nothing on television. So, the people want the brokers to drive them all over town looking at businesses.

So, what you have to realize is number one the broker's usually working on the other side, and the broker normally wants a financial statement. What is the key rule? The top 20 tops ways of finding a business. If you want to finance 100%, 18 of them work. You're going to find then, there's two categories that do not basically work all the time with 100% financing, and one is business brokers and the other is the area of merger and acquisitions companies which we're about to go through in a couple of minutes.

Now, let me tell you the biggest problem you're going to have when you go to a broker, a lot of you go to this broker or the merger and acquisition person and say, "Look, I'm trying the Hamel program. I'd like to own a business. I have no assets. I have no cash. I have no experience. I don't want to do anything. I just want to take off for the south seas and I want you to mail me a check." That broker will then tell you, "If I find something like that, I'll buy it myself." And, what they also then call me back and cuss me out and say I'm teaching the wrong thing. What you're doing is doing the wrong thing.

If you want to go to a business broker, go to the business broker for them to find you a business or help you put it together. Don't rely on them for financing. They don't even want to hear about it. They don't want to hear about our program. What they want to hear about is what do you want to own? What do you have? If you are able to keep it down to what you have and be cool, and then do the second thing – provide them with the proper backing.

Now, later in this program in one of the other areas, we talk about running a financial statement, a million dollar statement, having people put up real estate as a guarantee. The one thing I want to state here just like we state in the other LESSONs, you have to realize you can't put the cart before the horse. The problem you have when you go to a broker and you don't have the financial statement to qualify you to buy that business is the problem is you don't have enough of a financial statement. You don't have enough security behind you or cash. The problem is a lot of you come back to us or go to other organizations to try to get help in this area and it doesn't work because people are not going to put a financial statement, are not going to do anything until you have the business locked-up. You have to have an offer made an accepted.

So, you say, "How can we get it? They won't give us the numbers until we do the following." What you have to do then if the broker is blocking you, is either avoid the brokers or sidestep, go down the street, and find another type business, make an offer on it. Have somebody come in with you're your family or somebody else with a financial statement or a real estate guarantee, and buy the business you're looking at or if you then want to go back to the business at the broker or the merger and acquisition person has, then go back.

A lot of you think that certain programs that we put forth and teach you and educate you in are programs that don't work. And, the problem is you go out and try to use them and it's not that they don't work. You do them in the wrong order. I hate to say this – you have to do them by the book. You have to do them in order, and when you do them in order, they work. When you do them out of consequence, what you're doing is fighting the system. You have to quit fighting the system. Then you fight the system, the system doesn't work. You come back and blame us. What you ought to do is blame yourself. You're doing it the wrong way.

The next category, category 19, has to do with merger and acquisition companies, and again merger and acquisition companies basically are companies that we find that sell businesses at net maybe over 50 or 100,000. There's some out there that work on businesses that net over $250,000, but again we have business brokers that are working on small businesses maybe up to $100-$200,000, and those are total prices. So, they're mostly in the mom and pop category.

What we find with the merger and acquisition companies, they're working in basically the larger areas, $250,000 up to five, ten million dollars net. Again, there's a third category we don't even talk about which are basically investment bankers that do a lot of the merger and acquisition on companies that are up in the hundreds of millions or billions of dollars. The reason I don't want to mention it here is it's not a main category for us because very few of you go after business that large. I don't want to say none of you do. That would not be true. Not many do especially the first time out.

Now, again, they're much like business brokers only bigger. They deal in larger companies. They're highly professional, and we say they're a delight to work with. Again, I'm not going to say every one of them has been a delight to work with over the years, but on the average they are very professional people. A lot of them are attorneys, CPAs, other types of professionals, stockbrokers, and they work with larger businesses. They are not sales type people, and overall generally speaking, they do a very professional job and we enjoy working with most of them.

The last category we're going to talk about now is section 20, management consultants, and the great thing about this is the management consulting business, you have to realize that a lot of the people are business brokers or they're merger and acquisitions or even bankers are basically also in the area of management consulting. So, sometimes these areas tend to overlap.

These individuals and firms basically are the inside track of business. They also know what's going on even before the news hits the street. The know about businesses that haven't been listed yet because let's face it, if you're starting to think about our program, the Hamel program, the thing you have to realize is the reason we – myself and you – are so successful is the fact that we end up most of the time buying businesses that haven't been shopped. They haven't been presented to brokers yet. Most owners don't even know they want to sell. Okay? They've thought about it, but they really have put it in the back of their mind, and what we're looking for is a person who hasn't been beaten to death – somebody that's been trying to sell their business and has had 50 buyers there everyday. We're trying to find somebody that's fresh. We're trying to find one that hasn't been shopped. They're easier to work on.

Also, these consultants have priceless information about the current and potential worth of the business. They have a lot of back-up information, and since they're professionals, you should assume they deserve a fee for the effort on their behalf, and again keep in mind one thing as you go through these different areas and you're working with the professionals – again, the attorneys, the CPAs, brokers, merger and acquisition companies, consultants – the one thing you have to keep reassuring them on is the fact that the fee can be paid and will be paid. If the seller isn't going to pay the fee, make sure that you reassure them. Sign a contract. You're paying them the fee, and the key thing to keep in mind is in every person and every transaction that you work on, what you have to do is make sure everybody comes out of that transaction happy. Everybody becomes a winner including the professional supporting it. If you don't do that, you're not going to be able to put together a transaction.

You're going to find people are not going to want to work with you, and although a lot of you get irritated about the fees that these people charge, the one thing that I want you to keep in mind is the amount of money that they charge you is insignificant compared to what you'll end up with dollar-wise in the business you end up going into. So, quit being chinsey. Get all these people working for you, and how do you do it? It's called sharing the wealth and letting them know it. Again, just don't do it verbally. If you're going to share a wealth with them or pay a certain fee either as a finder's fee or a professional fee, put it in writing and when they do deliver and perform, pay it. Don't Mickey Mouse around. Take care of them, that way when you go onto your other businesses, you've developed a good reputation for paying, a good reputation for being professional in buying or running businesses. Then when you go out to the marketplace the second time, third time, you're going to find you have all these people to start you right from the start, and you don't have to start at ground level or ground zero. So, don't be afraid to share the wealth.

LESSON 3

In LESSON Three, we're going to be talking about a key document called a Profit and Loss Statement. I'm sure some of you listening to this tape are even aware of what a Profit and Loss Statement is, and don't let it mystify you. It's one of two basic documents we need when we're getting involved in business either analyzing it or running the business, and one document is a Profit and Loss Statement which is it making a profit? Is it showing a loss? And, the other document is a document in the next section which has to do with Balance Sheets or the assets and liabilities.

In this section, we're going to start going through the area of a Profit and or Loss Statement, and if you want an example of this what I'd like you to do is just open your book and turn to page 3-7. Pull 3-7 from your book, and close the rings, and then turn back to the first section which is page 3-1, not the first section but the first page in this section, 3-1.

First of all, we have this business it's called "The Store", and you probably notice going through the program that we use different type of businesses and we go through. We're talking about manufacturing. We're talking about distributorships. We're talking about a service business here, and the reason why we do that is you're going to find as you get involved in business that all business are basically the same and although you may have this fantasy in the beginning about them being different, you're going to find there's very many similarities especially in the area of the key documents like the Profit and Loss Statement. As you go through this one or other parts of this program, you'll go through a manufacturing company, you'll see the key areas on a Profit and Loss Statement that do vary.

What I'd like to do now is take The Store here, and again, this happens to be a real business. No, this is not a business that I own, and the reason I'm not using this example a business I have owned or worked on because I needed a business that had fraud involved because as I'm going to be going through this I'm going to show you some of the tax problems you'll have from a standpoint of what the former owner is doing, and also where people are playing games and Mickey Mousing.

Again, I'm not doing it from a standpoint of teaching Mickey Mouse, although you could do this with this information, but what I'm trying to do is show you what you're going to find when you're analyzing a business you were to list or to buy it.

So, just set that on the store, and then by looking at 3-1, let's start going through the different information and see what we have on this Profit and Loss. First of all, we're talking about two different methods of accounting. We're talking about the cash method and we're talking about the accrual method. What we're really talking about is how do we handle it from a tax standpoint, and the key thing is going to be very disappointing as you get involved with businesses if you're not already, is you're going to find the average Profit and Loss statement never does tell what the business is doing.

All we basically have on a Profit and Loss statement is a profit or loss that was set up to reflect the lowest possible net for tax purposes, and I've been in this business for a long-time as I tell many of you. I still have that place on my wall for the first honest Profit and Loss Statement, and I still haven't seen it. I'm sure it exists, but I haven't seen it. The main reason being of course, people do cheat on their Profit and Loss statements, but the other thing is it is set up to reflect the tax line as opposed to representing to somebody what the business is making which means we've destroyed the past few years the profit and loss concept.

When we start talking about cash basis of accounting, what we're saying is the owner of a business is able to write-off their expenses as they pay them. In other words, you're not allowed to write them off as you incur them, as they happen. You're only allowed to write off your expenses as they are paid. So, what we have here on cash basis Profit and Loss, if you're looking at 3-1, we have $10,000 income in January 198x, and at the same time during January, we paid $8,000 in expenses. These are the bills paid. So, on a cash basis method we would show a $2,000 profit which would be what? Basically taxable at this point.

Now, this is a rip-off because bills paid in January are usually the December and November unpaid bills rather than expenses incurred in January, and who are we ripping off? We're ripping off ourselves as business owner because we then assume we had a $2,000 profit, and we didn't because what you have is you have the income in January minus the bills paid. That is not a Profit and Loss statement. That's really a cash statement because what happens as I said is you took in $10,000, you paid out $8,000 and you have $2,000 left. That does not mean you made a profit because what you're going to find probably as an example in January you'll take in $50. You won't pay any bills. What do you do? You show a profit.

You're really not showing a profit. What you're really doing is showing that if you take the money in, subtract the money that you spent out, you have 'X' number of dollars left in your hands which is more a relationship in how the cash is flowing in the business, and what you're going to have to find – you have to take on a Profit and Loss statement – you have to take the income or sales for the month, and subtract the expenses for that month, not for the bills paid. You have to subtract the expenses. If not, it is not going to reflect what the business really makes.

What I want to tell you as I tell everybody else in the United States, most of the business owners we run into that are on the cash basis are doing it wrong. Most of the business owners that we run into that are on a cash basis and doing it wrong are still very successful. They're make $10, $20, $50, $100, $200,000 a year, and they're doing it wrong. Again, I don't want to encourage you to do it wrong, but even if you're doing it wrong you're going to find because the average business owner doesn't know what he or she is doing, you're going to find that your competition is not as strong as you think it is. If you end up doing it wrong, you're going to find you're probably still going to succeed.

What we're trying to encourage you to do in this program is at least do a few of these things the way that we suggest, and if you do that, and if you're competing against people that do none of them right, you're going to find that both of you will probably stay in business, but you'll end up making more profit. You'll then be able to weather the recessions, the depressions. Why? Because of who you're competing with. You're competing with business owners that basically don't know what they're doing. Most of them don't have the tools, and the ones that do have the tools aren't using them.

Now, the other method here as we said the other method of cheating, we're going to talk about that in a little while, but before I do that let's mention the other method of accounting because what we're talking about is the accrual method. In the accrual method, basically what happens is we have an owner of a business and what they do then is they accrue expenses. Each month they not only are able to write-off or expense the bills they had, but they can accrue. What you end up with an accrual method, you end up with a more accurate Profit and Loss statement. We'll get into that later.

We talk about other methods of cheating in this area what we're really talking about is what happens when you're going to buy a business. You go up to this business owner, and the business reflects $50,000 net profits. You say, "Oh boy, that's wonderful." But, here's what happened. Let's set the scene. This is now January in our example here, February, and as you go back last year to last October and if you're in the sellers office you're going to find the seller saying, "Hey, this year we're only going to show a profit of nothing. We're going to show no profit. We're going to show no loss. I'd like to sell this business." And what you're going to find is he'll then sit down and talk to the suppliers and vendors and say, "Look, I'm paying my bills on time. Would you mind if I pay what I normally pay in November and December and move it maybe to January of next year?"

What happens is then this business that shows no profit, by them taking $50,000 of expenses from the prior year and say moving it to this year expense-wise, what you're going to find is if they move $50,000 of expenses on a business that showed no profit, how much profit will it show? That's right, $50,000. Did it really make $50,000? No. Could they make it show $150,000? Yes. They can make it show any number you want, and is it really making it? No. What's happened? You the buyer or the person listing the business has just been ripped-off. Do they do it quite often? Unfortunately, yes. Owners are not stupid.

The next thing is the inventory and what we're saying here is sometimes they take inventory annually, sometimes more often, sometimes it's estimated. The thing that's key here – the largest expense item in many businesses or most businesses is subject to the least control. What areas do they control least usually? Labor and the other thing is the cost of sales – what does it cost to operate, what is the inventory.

Let's take the example here that we have on the inventory and see what we have. First of all, the beginning inventory is what? $50,000. We're on 3-7 now under cost of sales. The next item down below under purchases is $200,000, and then we have an ending inventory of $50,000. What does this say basically? Well, the way you arrive at a thing called cost of sales is you take the beginning inventory – whatever the number happens to be – in other words, how much stock did we start with. You then add in the amount you purchased during that period either during the month or during the year, and then you subtract the ending inventory. If you do this and you do it properly, you'll end up with what your cost of sales were.

And, what does cost of sales mean? Well, basically in this business it is a women's clothing store, it will mean during the year – looking at 3-7 – the cost of sales were $200,000 which means we bought $200,000 worth of dresses and we resold them for what figure? $500,000. So, the cost of sales was across the bar merchandise or a garment, and this is what happens in a retail business. If you're in a service business, you're not going to have cost of sales. Why? Because you don't have a product, all you have is the services of people.

In the other example we had in the area of pricing, we used M Manufacturing, and with M Manufacturing under cost of sales in addition to having material, what we really have in manufacturing company is what if you will recall? You have material which comes in which is raw material, you add labor to it, mark it up and sell it which happens in manufacturing.

In a retail business, we don't have that. You have the material coming in. We add nothing to it. We just resell it. And how we make our profit? We mark it up – add X number of dollars to it as we resell it to give your sales of profit.

Now, in this example right here, we're going to have you moving about a bit. We'll come back to page 3-1, but while we're doing this, let's turn a couple of pages. Let's turn to 3-5. You should have 3-5 and 3-7 in front of you now, and what I want to do is talk about the inventory.

Now, first of all in this example right here on 3-5, we had beginning inventory of $50,000. We have purchases of $200, and then we subtract the ending inventory to get cost of sales. That's great, but did you notice that the beginning and ending inventory or both the same? What does it mean when the beginning and ending are both the same? Well, what it normally means is they didn't take the inventory. In fact, you'll see many companies that takes the inventory and it's $50,000.02 and you'll find that it's run that 50 times in a row. You're going to find they've estimated the inventory or basically what they did is they didn't even take it.

Now, how accurate is this? Some people are going to tell you this averages out and that's a flat out lie, or it's a statement made by somebody that doesn't know what they're talking about. The beginning inventory is $50,000. if you then add back in the purchases down below which is about half way down on 3-5, of $200,000, you'll notice in this example the second part which is the real world, we have an ending inventory of zero. Now, I've exaggerated this example a little, but let's suppose this had happened in this business that we have here. Well, instead of having cost of sales of $200,000, what are our cost of sales? $250,000. If you then take this back to the example that you have on 3-7, what would happen in the real world? This business is showing an inventory cost of $200,000. What is the true inventory cost? It's $250,000, and if you build the real numbers back into example of 3-7 instead of having a profit of $50,000, what is your profit? Zero.

I don't know exactly how to approach this now, but I have to tell you this next thing. even though we're talking about tax fraud, we find it comes up quite often. What you're going to find is owners of businesses when they're making out their tax statements, will take their tax statements and not want to pay a tax, and how do they avoid paying a tax? By Mickey Mousing the cost of sales. As an example, let's say 3-7. You own a business. You show a profit of $50,000 as you get down to end of the year, you decide you don't want to make a profit for tax purposes. Well, it's very simple. You could pay bills ahead of time which is legitimate and what you'd find is you'd end up not showing a profit. But on the other hand, the other way to do it is do a thing called writing-down which is in some cases legitimate, but we run into a lot of business owners that in the area of cost of sales will take the cost of sales figure and adjust it.

In this example right here, if your true cost of sales did happen come to $200,000, and you wanted to Mickey Mouse it, you could just make it on your statement $250,000, and when you do that you wipe out your tax.

Now, as you start looking at this, I want to warn you about something you're going to run into. You're going to run into businesses as you go out to look at them or to list them, and you're going to find that they're showing $50,000 inventory on the books. When you walk into their warehouse, it looks like they have a million. Well, you're correct. They do have a million. And, what they do then is to play games, and they have all this excess inventory, and if you want to figure out how much they've ripped-off your government for or our government, it's the difference between the inventory that they show on their books and what they really have there, and this is Mickey Mouse.

This is tax fraud and what I'm trying to warn each and every one of you is if the seller of the business tells you that he or she wants to then run that inventory back through the business after you buy it, tell t hem to go somewhere because what they have done now is they have ripped off the federal government. I'm sure they've ripped off the state government. They probably have cheated their employees, but for you they've got a deal.

What we do is we give these people a hug and we tell them we're not interested. If you get involved in these businesses whether you're working as a buyer or whether you're working as a broker, you're going to get yourself in trouble. If you do, don't come back to me because Hamel warned you. You're working with a person that is now guilty of felony fraud, and what I suggest you do is stay away from them. You do not need that Mickey Mouse business. There's plenty of them around that are not playing games. But, if you do it – I warned you. I've seen many, many people in the past get in trouble. Don't do it. You don't need that business. Also, what kind of transaction are you going to have with somebody who does this because you know if they're doing it in one area, the next thing they're going to do is rip off you either the buyer or the agent and you end up getting in trouble. So, my word is don't do it.

Let's go back now to page 3-1 and talk about a thing called common ownership under number three, and it says, "Does this Profit and Loss Statement reflect the income expenses of this business only?" And, what we run into sometimes, the owner will own two or three businesses, and what they'll end up doing is they'll run expenses from one business to another.

A few years ago, we had an owner of a business that owned two different companies. One company showed a large profit. The other one showed a large loss. Why did one company show a large profit? Because the owner was running all his labor against the loss company which means the other company that would've probably been breaking even, showed a big profit. Why? They didn't have a labor figure. Was it included between the two companies? Yes.

What I'm saying is you better go slowly. You better dot your I's and cross your T's and even though we're telling you how to verify and check things as you're going analyzing businesses, you have to realize when you get down to the end, you're going to have to have a CPA go through the books everytime and verify and reverify everything. For those of you who don't bring the professionals in later to check the books and verify them and make sure you haven't been ripped off, you will get ripped off.

The amount of money that you spend for the professionals in the business whether you're buying it or putting up a business transaction is worth it. Every cent is worth it. Why? A business transaction is complex. I don't care how smart you are or how bright you are, you're going to find that you are not going to be able to keep up and you're not going to be able to be that brilliant in all the areas. So, bring in other people. It's worth it. You're not wasting money. Believe me.

The next area, owner benefits, perks, volcanoes. When we start talking about perks we're talking about perk and benefits and it says, "See detail on the Profit and Loss adjustment sheet", and we're going to get into owner benefits a little later, and as we do you're going to start to see what the perks are, the benefits. Again, a perk is something that basically we're talking about in a large company. The president of a large company has a company car, a special insurance program – things like that. And, you're going to see in large corporations although they do have a lot of these benefits, it's nothing compared to what the small business owner takes as benefits in their business.

As we go through this a little later, you're going to find some of them are legitimate and other ones aren't. Again, we're not going to be trying to teach you the Mickey Mouse ones, but the thing is you go out to get involved in business either buying or listing them, you have to understand what the Mickey Mouse is. Why? Number one, if you appear to be not knowledgeable in this area, the seller is not going to be impressed with you and be fearful of working with you, and on the other hand, you have to be aware of it because you're going to have to try to determine in a little while how much profit this business is really making. We'll get to that in a few minutes.

Standard accounting practice is inadequate. The average Profit and Loss statement is set up and used over the year to lower the tax bite and not to run the business. The net profit that a business reflects is not a true measure of what the business is really producing, and I've said that a couple of times in this section, and what we're saying is the bottom line net does not really reflect what the business makes, it reflects what? It reflects the bottom line figure for tax purposes, and you can't use this to run a business and you also can't use this to buy or sell a business. Why? Because it doesn't reflect what this should be based on. We'll mention this again because it's very important.

What I'd like to do now as you've considered these different things, what I'd like you to do now is pull out 3-9 or just turn to 3-9, and on one side you'll have 3-7 and the other side you'll have 3-9. We're now in this section going to go through the buyer's Profit and Loss adjustment sheet.

Now, you're probably wondering in this program why we just didn't sit down and show you all the different accounting functions and how to put together books, and that's not our purpose because the purpose in this program is to show you how to analyze a business, and you're going to find in most businesses you'll have a Profit and Loss statement. You'll also have some sort of bookkeeping system, and all we're doing is showing you how to check those things out.

As you check those things out, you're going to say, "Is this all that you check?" Well, this is all we're checking at this level because this is where you're going to find most of the fraud, most of the misrepresentation, and most of the things that are going to make it difficult or impossible for you to make a decision or to analyze where you're going either as an agent for one of the two parties or as a buyer of a business.

As we think about the buyer's Profit and Loss adjustment sheet here on 3-9, you're going to find that what we're going to do now is build back into the company different perks and benefits because we're going to try to find out what it's really making because right now it shows $50,000 and it's paying tax on $50,000. And, over the years what we have found because we have had the opportunity in our program to own a lot of companies, we've also had the opportunity to analyze a lot of companies for our own purchase and also analyze companies for the tens of thousands of graduates of our programs. So, we've analyzed hundreds of thousands of businesses over the years. Our average that we have found, and again it's not scientific but based on our studies over the years, we have found when a business is paying tax on $50,000, we usually find another $100-$150,000 of perks and benefits that the owner of the business is taking.

Now, what percentage are legitimate? We have tried to keep track of that. I'm sure the IRS has. What we've looked at it is from a total standpoint. In other words, this money is really profit of the business. Some of it is taken as tax benefit. The other they're cheating on. Is there cheating going on? Yes. I'm not going to hide it. If you want to go talk to the Internal Revenue, Internal Revenue's going to tell you that's why they have so many agents because the games people are playing.

One thing I'd like to mention at this time – for those of you that are going to go out and consider playing games on taxes, I've been working in this area for a long time not in taxes but in the buying and selling of businesses. It always makes me laugh because the average person I've run into is Mickey Mousing on their taxes and as we go through it, and again we're not tax experts, we find that they have missed write-offs that are equal to or greater, and what they do is they spend many, many hours every year trying to cheat on their taxes, and we keep trying to tell them why don't you get a good CPA or a good tax advisor, spend the money. Not only will you get many times the money back that you spent on that tax advisor, but the amount of write-off you get legitimately is more than you're cheating on now which means everything you're doing is stupid. It's counterproductive. It's negative, but again, do it your way eventually you'll come around to my thinking.

We keep trying to tell you you can make more money in business honestly than you can dishonestly, and what you should do is quit wasting all your energy on all these other Mickey Mouse schemes and scams. As we start to think about the buyer's Profit and Loss adjustment sheet, we're going to start at the top with $50,000 net. We're going to take the $50,000 and whatever the figure is off the bottom of the Profit and Loss statement, and we're going to add and subtract things as we go along to see what number we end up with. So, we're going to have positive adjustment. We're going to have negative adjustments. Then, we're going to find out how much profit's available, truly available in this business.

One of the first things you're going to run into is the owner. The owner's pulling out so much, and when you get involved in analyzing business as an agent or if you're going to do this as a buyer, you have to get it down to the point where the thing makes sense.

For those of you who are selling your business, you have to do the same thing because if you're business only shows $50,000 net and if it's truly making $150 or $200,000 and you don't present this in the right manner to the other party, you're not getting the right price or value for your company. You're selling it for a lot less because you're business does make a lot more than the Profit and Loss shows.

Now, as we start to go through this, the first thing we have is the owner, and if we look at 3-7, if we go down, look at under salary of officers, it says $80,000, and you're going to find the owner then is pulling out $80,000 from this business. The owner's paying himself $80,000. So, under owner we put $80,000.

Now, let me explain what we're doing right here. First of all when you get involved in businesses like sole proprietorships which we have here, you're going to find in this business that what we have is an owner running his or her own business. In this example right here, this business shows $50,000 bottom line net, but that's after the owner has pulled out how much for themselves? $80,000. As you go down the street and pull out the same size business you're going to find another business down the street showing $50,000 net after they've paid themselves $20,000.

On the other hand, you're going to find an owner on the other end who's paying themselves $150,000 a year for a salary and still shows $50,000, and as you analyze this you're going to find that one of the owners is pulling out $20,000 plus the $50,000 net shows total what in those two categories? $70,000. The one in this example right here is pulling out $80,000 plus $50,000. That's $130,000. And, if you look at another type business we mentioned where the owner's pulling out $100,000 plus the 80, that's $180,000.

Now, what I'm going to try to show you here now is you have to compare apples and apples. What you have to do is you have to sit down and try to figure out how much the owner's making, A, and you push that back in and you push back in the $80,000. We're then later going to back out what a manager's salary is. Now, why do we back out the manager's salary? We would like to get every business for analysis purposes down to the point where what we're looking at is what is the bottom line net after we push back in all the owner's perks and benefits legitimate and not legitimate, and then subtract out what a manager's salary is. This way you can compare apples and apples. It is a clean business, free of what the owner does, and it has a manager built in, whether the manager is there or not doesn't make any difference. If you don't do it that way, you're never going to be able to figure out whether one business is better or not as good as the other business. So, let's bring it back to one basic level. It will also help you find out what they're really making.

Now, this owner is pulling out $80,000. You say, "Well, is that a standard for a business?" There is no standard. If you don't believe it, talk to Internal Revenue Service, and you're going to find certain businesses that are very small and the person is basically work at the department level, running the department, that person is paying themselves $150,000-$200-$300,000 a year. Is that excessive? I'm not in a position to judge. All I'm saying is this is why IRS has so many auditors because of problems like this.

On the other hand, you're going to find a number of owners that don't pay themselves anything or pay themselves something less than minimum wage. Is that fair or legitimate? No it isn't. And, what we're trying to do is get it back to a legitimate level so we can analyze these businesses, put them in the proper order so we can find out where we're going.

So, what we do is we push back in the $80,000 and where it says "Owner" we add back in the $80,000. Now, let's go down a couple of lines. We'll go back to talk about the spouse, but if you look under the area where we say deductions for net profit it says $42,000. So, what we're doing is we're pushing back in or adding back in the $80,000 the owner did take out last year. We're now going to subtract out what it would cost to replace the owner or the manager. Now, if the manager's already there you don't have a problem, but let's say right now we have to add back in a manager. How do we find out what the figure is?

Now, we're not going to use government averages because that's what they are, they're averages. You're going to find they're too far off to analyze a business. So, what we normally do is we'll pick three or four business owners in the community, call them, and find out what the going rate is for that type business. Yes, we're talking about competitors. Don't tell me you can't get the information. You can.

What you do basically is you take the average. You may find one was $38,000 something, another one was $42,000, and the other one was $44,000. As you take the average of these three or four that you're looking at, you find the average including payroll taxes and other benefits came to $42,000 which is great. It's going to cost you $42,000.

Now, for those of you agents, attorneys, CPAs that are representing clients, you just don't call people and change the numbers. What you have to do as you call these different people, I would suggest that you get their name, you document the time you called them, and make up a letter that's like dictating letter to your file. The only reason we're doing that is to document that we made the call so that if something goes wrong and we have to go to court, we can tell the judge we at least did it semi-scientifically as opposed to just plucking it out of the air.

If you do it this way, you're going to have a pretty good number. You're going to have a number that's pretty accurate.

Let's go back up and talk about the spouse now because the spouse also gets involved, and again, a lot of you think of a wife, but we also know that business owner's some happen to women, and their husbands are involved. It might be a boyfriend or girlfriend, but again another member of the family or another friend.

Now, what we have quite often in business you'll have the main party running the business and paying themselves very well, and then when you get down to the second level, a spouse, you find they're usually not paid or paid very little. Now, a lot of times, they're keeping the books or doing something along that line. They're not being paid. When you then as a buyer come in to take over this business, you may have to replace the spouse with somebody making 25 or 30,000 a year, and when you do that, and you're buying a business making 25 or $30,000, you've just wiped out the profit, and you're back at zero. So, analyze this and find out where you really are. Are you going to have to replace somebody and what is it going to cost?

In some cases you may even find the spouse is making more than it's going to cost to replace them. But what you have to do is find out where you are and do it. Does this come up very often? Well, if you're new in the field, and you're about to go after you listen to this tape program and do it, within one week of doing this full time you're going to find that the spouse probably comes up almost every other time. It comes up quite often.

The next area that we have is a thing called relatives, and you're going to find businesses with relatives working in there also, and the relatives are either working for a lot more or a lot less. In all the years that I've been doing this, I don't remember one where they're working for exactly what they should've been. Let me give you an example I used to use in class a long time ago, and the reason we used to use it is the fact to display what you're talking about.

We analyze this business that was making about $30-$40,000 in profit, and as I analyzed it, we noticed that the total payroll was only $8,000. With a total payroll of $8,000, next to it, it said, "We have the following number of employees." I believe the number was like 25. Well, if you're not looking for it, you're probably not going to pick it up. When you think normally $8,000 a year, I don't care what year this is that you're listening to this tape. Twenty-five people at $8,000 isn't much.

And, what we had was we had a person that was working there part time, and the other people that we had mentioned on this list were people that were working there for nothing. They were friends, relatives, most of them were relatives of the owners. The owners were in their mid to late 80s. They were very sick, very old, and the grandkids, nieces and nephews and everybody in the family was working there for nothing. Why? Because grandma and grandpa were in the process of making out their will or changing the will. Why do they work there? They are hoping they'd be favorably mentioned by grandma and grandpa.

Incidentally, as we took that business that was showing, again I don't remember the exact number, say $35-$40,000 net profit, and we built back in the different relatives and just did at the minimum wage that was in effect at that time, we realize that business went from almost $40,000 a year net to about $30-$40,000 in the red just on that one area. So, this is not just a minor thing. It's a major thing. Are you going to run into it quite often? Yes. Are owners going to tell you that they're doing this? No, because what owners are trying to do when they're working with a broker or they're working with a buyer, they're trying to tell you all the good news about the business. We call it creative embellishing. What is it also known as? Probably lying, but again, people tend to misrepresent the first couple of times when you're talking to them, and we usually find by the time we've talked to them a third or fourth time, we've established a repore. We're getting much better answers. We're getting answers that are closer to the truth. It doesn't mean they're liars. It means they're trying to sell you something, and in their anxiety they bend the rules a little.

We talked about payroll taxes and I've built that in already into the manager's salary. Let's go down to auto expense. Annual auto expense – what we have is we have an automobile and the expenses on the profit and loss if you look under operating expenses come to what? $12,400. Now, we took $12,400 here what we have is $8,000 that aren't legitimate. So, we have $8,000 not legitimate out of the $12,400.

The thing of this though is how does that happen? Well, this is not skimming. In other words, if an owner comes to me and tells me that he has a second and third set of books, the thing that always makes me laugh, the average owner doesn't even have a good first set of books. What we're going to find is they're doing a thing called skimming. It happens mostly with small business owners which means they're not running all the money through the books.

As you start to get into the larger businesses above $50,000, very few business owners are doing a thing called skimming, and the reason they're not doing that is there are three or four people working in their accounting department, and if they do go out and start to play games, they have three or four witnesses which end up with lifetime income because you can't afford to get rid of them because they'll turn you into IRS. So, the average owner of a business over $50,000 cheats on their expenses. It's not that they're better people.

They're just cheating in a different area, and one of the areas that they cheat in is auto expense. IRS has very definite rules that have to do with auto expense, and it has to do with what percentage of your car you can use in the business and whether you can tie in every car you have in the family, and what we find on the average, and it's not that much exaggerated, the average business owner will write-off their company car, and they'll write-off every other car they have, and even though they're not using it 100%, they're writing it off 100%. In fact, they keep teasing about the fact that if they don't have enough cars, they'll make up cars.

For this example right here, we do have an example of tax cheating. Well, you can decide for yourself. In this example right here, we have two children – the owner's children, they're going to college. They're expenses come to $8,000 a year on their automobiles. Now, this is not skimming. This is expense Mickey Mouse, and what you're going to find is you or your CPA can go back to the books and in most cases the owner will have this isolated. You can actually dig it out. For you IRS agents listening, you can do the same thing.

You're going to find that they have this excess auto expense, and as you go through it you're going to find the kids are going to college. The question you should ask is, "Do they work for the company?" No. Since they don't work for the company, is that legitimate? No. Do business owners do this? Yes.

You start to go out after listening to this tape program, what I'm trying to do on this tape is explain the real world to you because as you go out the next week or the next couple of days to look at businesses, what you're going to find is exactly what I'm telling you about, and again I'm not trying to train you to become a tax cheat. What I'm trying to train you to do is go out and analyze business properly and if you don't understand what the real world is, you're never going to make it, and you better start to realize they're doing this. Don't be shocked. This doesn't mean you should be copying or doing the same thing, but don't be shocked at what's going on.

For those of you non-believers that don't believe this tape, why don't you sit down with your favorite IRS agent and let them talk to you about the problems they have or read some of the material.

Travel and transportation, as you look at the travel and transportation, you're going to find that travel comes to $24,900, about the second item from the bottom under operating expenses, and as you look at 3-9, you're going to find the travel and transportation they number that we have built in is $19,700. What does that mean? That means of the $24,900 of travel, $19,700 is either not legitimate or are expenses that you may not have to get involved in.

In this example right here, you're going to find that grandma and grandpa or mom and pop that happen to own this business, happen to be doing business in the Far East. Do they have contacts over there? No. Do they buy things over there? No. What do they do? They document, and you're going to find a normal business owner has the mentality, "If I don't get audited, I don't have to worry about it." I'm not saying that's right or wrong, but all I'm trying to explain on this tape and this is a very dangerous area and a very narrow line I'm trying to walk right there. I have to give you the information, but I don't want you to get the wrong idea. You have to stay away from the tax cheating or you'll get in trouble with the IRS.

Now, the thing I want you to realize as you look at this, you're going to find this in a number of businesses. Does they happen quite often? Yes, it does, and that's what IRS looks out for and on their audit, but the key thing is documentation. The key thing from your standpoint in analyzing a business is it a legitimate expense? It's an expense that you as a new owner or the person analyzing a business can build back in as part of the profit. It's an expense that's non-recurring. It's an expense that you don't have to have in the business other than you're looking for the trips to the Far East and you want the IRS or the government to pay for it. But, from the basic standpoint, this is not legitimate this $19,700 is not legitimate.

The next category we have here – we're going to talk about pension and profit-sharing, you'll find this coming up, and we find again, if it's pension and profit-sharing for the owner of the business fine, you can add that as part of the money that that corporation has. Now, keep in mind as you're going through this and we'll go through this in another section, although these are dollars that are available to add back into this business for valuation, it doesn't mean that all these dollars will be available to pay loans or to feed you and your kids later. Again, we'll talk about that later as we get to the section on cash flow.

The next area we talk about health insurance, we're talking about a thing that's called business, that's legitimate, and we get into health and life, and you're going to find this example here, we take the whole $16,600 and add it back in. The reason for that is there are laws in this country that keep changing from year to year, and it has to do with the form of ownership of a company whether it's corporation or personal and also whether the benefit programs you're setting are health insurance and life insurance are just for you the owner or for everyone.

In this example right here and analyzing it, we found out that of all the health and life insurance programs that they're writing off, not one of them was legitimate. Now, I don't want you to get the feeling that you don't want to or don't have to give your employees health benefits or life insurance benefits. The key thing to do is sit down with an insurance broker or insurance company. Find out if it's legitimate. Your CPA is going to be able to tell you the same thing. If you're going to set the thing up why don't you set the thing up right?

But, in this example right here, what we have is $16,600 which is an expense to the business that you're going to add back in. Why? Because the owner has developed his own program. In this example, we have own that's not legitimate tax wise. Was it a mistake? I don't know. That's up to IRS to figure out, not me.

As you start to go down, let's go back and finish up the example and you'll find if you take the $50,000 net. We had a $50,000 net profit. We add that in at the top, or excuse me from the top, and you'll see on the bottom it says, "Net profit $50,000". Below it says additions. If you'll add up all the additions to net profit from our first column there, it comes to $124,300. If you then subtract the deductions you have and in this example it was a manager's salary, son of a gun, you end up with an adjusted net profit available to the new owner of $132,300.

Now, again, as I've told in the example before, we have found over the years that this is a little below the average and if you're looking at the average business we've run into, you would find that although it's paying tax on $50,000, there's another $100-$150,000. So, the number you find under the adjusted net profit would not be only $132, you'd find it would be somewhere adjusted, somewhere between $150 and $200,000. Again, is all this available to pay your bills and feed your family? No, they aren't, and we'll talk about that later when we get into the section on cash flow.

LESSON 4

We're not going to be going through and discussing a thing called the balance sheet, and there's two key documents that you basically have. Now, this is Section Four in your book, and you're going to find as we go through this, we're going to be talking about the balance sheet, and this in addition to the Profit and Loss Statement are the two key documents that you're really trying to get yourself involved with and check in details, and these are the areas that you're going to have to have the most experience either doing it on your own or having a CPA or accountant help you as you go through this area.

Again, what we're attempting to do here as we go through this section is we're attempting to uncover the different problems you're going to have come up 90-some percent of the time. As a number of other things come up, they don't come up in a significant number. So, what you should do is learn the different areas that you're going to have problems with, and as you go on you're going to pick up an education in the other areas. But, again, I'm not going to cover anything that doesn't happen continually. Again, if you go out tomorrow, and spend a week, by the end of the week you'll be able to teach this section.

What I'd like you to do first to make it easier for yourself as we go through Section Four is why don't you turn to page 4-9, and pull 4-9 out of your book which happens to be the balance sheet for the ABC Company.

Again, what is a balance sheet? A balance sheet is basically a document that tells us in business what the assets are, what the liabilities are, what the net worth is or how much does the owner own, which is basically the net book value. What you really find is if you want figure out what this is mathematically, it's assets, which is the little things you can clutch – the cash, the equipment. We then subtract the thing called liabilities, what do you owe on these items or what do you owe on the business. You subtract that. And, you end up with what? You end up with a thing we call the net worth, or how much the owner has in this business as basically a book value.

Now, the thing you have to realize as you start to go through this, we go to 4-1, we have document like most other documents in business that are not very accurate. These documents are misrepresented. Many of these documents are manufactured on the dining room or the kitchen table. So, you're going to find they're made as instructive, or made as to whatever the people are asking for them. So, be very careful as you're checking these things out.

I also want you to realize those of you buyers will also use the balance sheet as a negotiating tool. We use that after we've arrived at a price maybe of $100,000 to then go back to the seller asset by asset and if they assets don't make too much sense or we don't believe we want to buy them, we negotiate with the seller to have the seller subtract those from the price and have the seller keep those assets, and that way we end up lowering the amount of money we have to pay for the company. We do this all the time. We'll talk about that later.

First of all, on page 4-1, we have understanding financial statements. We're going to talk about four different categories of statements keeping in mind that none of the statements are very accurate. First of all, the audited statement, and I f you haven't been in business before, you're always coming to people like myself and say, "I'd like an audited statement. That's fantastic." But, the problem is in order to get an audited statement it costs tens of thousands of dollars and takes months to provide one. You're going to find that they're usually for a specific period, usually one year. There's a limited scope as CPA opinion because it's incomplete. Also, read the opinion carefully. It may spell out problems. In front, they don't only have the disclaimers and tell you how much auditing they did do, but it also spells out the problems areas that they are aware of.

It's prepared by a CPA, and again, the reliability is based upon how good the CPA is or how much expertise they have or how much the owner tried to pull off on them. Keep in mind, when you start to think about it, there's a number of companies out there over the years that have had the audited statements, and have misled the public. Again, I think of Equity Funding. I think of First National Bank of San Diego. I think of Rolls Royce, Pennsylvania Railroad, Lockheed, Chrysler – all of these companies have audited statements again for a long period of time. They sort of fooled you, and again the audited statements we don't think are that good. Again, they're better than what you're going to run into, but the chance of running into an audited statement unless you happen to be buying a company that has been franchising or maybe a company that is selling a stock on the stock market – they have to have audited statements – or maybe a large company that is getting a lot of bank financing for expansion or to keep going. In a lot of cases, the banks or the lending institutions are required then to have audited statements, but most of the time you're not going to find them.

The next one is the interim statement, usually not audited, used by business to evaluate performance. Again, it's not exactly as good as an audited statement, but again, when you see them, we check everything out. Dot every I and cross every T. Why? Because over the years we have found as you'll see in a short while, most of them are very Mickey Mouse, and certainly not accurate.

The unaudited year-end statement, again we're getting worse and worse here, it's signed by the company officer, dangerous. It should have an internal book audit, again, the unaudited year-end statement is about as accurate as they want to make it.

The estimated statement, which is really terrible is dangerous to base opinions on estimates. You need the figures that are clearly defined and precisely executed. What you have with an estimated statement, these are the ones that are basically in the category of what's developed on the ironing board, what they made up on their kitchen table or on the cocktail napkin at a bar somewhere.

So, what we're saying is be careful as you go through the statements. Again, I don't want you to become neurotic, but what I want you to do because understand there's a lot of fraud involved – some intentional, some not. What I want you to realize is just verify things. Take your time. Dot the I's cross the T's, and go slowly. You're not going to get ripped off.

As we start to go through this, you can probably follow this on 4-3 and 4-4, we're going to be going through the different aspects, and the first category we're going to have as you look at the balance sheet on 4-9, you see this thing called assets at the top, and the first thing is current assets. What we have here under current assets if you're looking at 4-3, it says the cash plus those items which the company plans to convert to cash over the course of its normal marketing process in the regular context of business. These are available conversion to cash as needed. And, these are basically things that can be converted in the next year to pay items in the next year. As we start to go through this, I'm going to following in different type order, I'm going to be starting with Aging Accounts Receivable, but in order to do that let's take the assets and I'll start with the third one. Again, we're going to come up to the top, and go down, but I will cover all five of them.

Let's take the accounts receivable. The accounts receivable of $120,000 – now, what we're talking about here is somebody has come to the company here and instead of paying cash they're going to pay for it in seven days, 14 days, 30 days which we do. We then carry it on our books or on our balance sheet as a thing called the accounts receivable. This is money owed to the company - $120,000. But, the thing is, are they collectable? And, although we mentioned this in other parts of the tape program, there's two things we're going to be doing. We're going to be doing a thing called aging accounts receivables to find out how many of them are accurate, and the other thing we're going to do and you offer to purchase later in the program, we're going to make sure the seller of the business guarantees the receivables. So, if there's certain ones that we take over as buyers we can not collect on, the seller makes them good. We'll get to that later in the program.

But, right now let's take the receivables, and what I'd like you to do keeping 4-9 out, I'd like you to put your finger in the page at 4-3 and turn to the back of the section, or if you're like, turn to the back and pull out the next to the last page or just look at and that's page 4-13. What we have on 4-13 is a schedule of accounts receivable, and aging of accounts receivable. What we have here is a list of companies, and again we don't have all of them. I just took a cross-section of them. I didn't take all the companies that make up the $120,000 that's owed. So, we took five of them. We have Al's Manufacturing. They owe us $7,000. Bob's retail, and as we go through this, we find of the $7,000 of Al's Manufacturing, $7,000 is current. They're not past due. So, it looks pretty good on the surface.

But, going down to the third one, we have Cal's Deli, and they happen to owe us $12,000. Of the $12,000, as you can see here, $8,000 is current – hey, that's good – but, we notice going over to the right, $3,000 is 30 days past due, and we have $1,000 that's 60 days past due. What you're going to find as you start to get up towards 60 days past due it becomes very difficult to collect the money. And, incidentally, if they're already up around 60 days past due, a thousand, and $3,000 30 days past due, how collectible will the $8,000 be? And, why are we still giving them credit? But, the thing you have to keep in mind when you're going through a scheduling or aging of accounts receivable, we're also talking about what here? We're talking about our customers, and you don't want to just blatantly when you're going to buy a company or get involved in a company, just go out and say, "Well, look, these people are past due, we're going to put them on COD."

You may end up losing your largest customer, and what you may have to do is you may have to go into that business, buy it, take over those receivables, and then start going to a person like Cal's Deli who may be a large customer and say, "Look, you're 60 days past due. Let's start moving it back and maybe over the next couple of years you'll get it back to 50 days past due." You don't want to break them, 45. The ultimate goal a year or so from now or two years from now is getting it back in line to maybe 30 days past due, or you may have to accept the fact that they're always going to be 60 days past due, and make that your standard payment period and stay on top of it so it doesn't crawl up to 90 days.

One of the temptations that many of you are going to have is to buy these at a discount because you hear about it all the time. Any ones that aren't any good, buy them for ten cents on the dollar. Well, the normal company you get involved in the people that you have now that are collecting this money are going to be the same people collecting it later, and even though you as the owner may be a little stronger in the area, you're going to find it a little difficult to collect and what I try to do in most cases when I'm buying a company or suggesting to you – why not just say to the seller of the business, "This one doesn't appear to be collectible, why don't you keep that and we'll subtract that – in this case here $12,000 – we'll subtract it from the price of the business."

What we find in most cases if the seller's very knowledgeable, the seller knows he or she is going to have trouble collecting this after they end up selling the business. So, what most of them end up doing in closing or at the close of escrow, is they'll turn to the buyer and say, "Look if you can collect this $12,000, we can split it." What happens is you don't have any money invested other than the fact that you're going to have labor invested. If you then collect it, you end up getting half of it. If you don't, it doesn't cost you anything. So, be careful with discounting. Although it may work in some cases buying at a discount, we find in a lot of cases, you end up paying money. Again, even ten cents on the dollar isn't worth it if you're not able to collect that ten cents. So, be careful of these bargains.

Now, you start thinking about the receivables later when you're going out to buy a business. One of the things that we run into when we're first getting involved in a business, we'd like to know what type of customers we have and who they are. Sometimes the seller will hold this back and not give it to you until after you've made the offer. Quite often what you could do if they're turning you down on that, is asking for an aging of the accounts receivable. The thing that's fascinating is it surprises me how many sellers do not even know what they're giving you.

Now, from the seller's standpoint, I suggest you take it from the other side, and again, I agree, do not give you out your customer list or your supplier list until after the offer's been made and the offer's been accepted and you feel good about the other party.

Now as you start to look at the accounts receivable, again you buy standard sheets and you buy these standard sheets from the stationary store. If you have a computer print out again, it's a standard item. What I want you to do after you start to buy a company is work on these to make sure these things are being collected on time because as they extend out you're going to find they become increasingly difficult to collect, and you end up having to write-off all sorts of money that you're business should've collected and should've gone to the bottom line as a thing called what? A thing called profit.

Now, the thing that also I like about you as a buyer going out and asking for this aging is the average person buying a business does not know what an aging is or even what accounts receivable aging is. Once you do this, you're going to find the seller's going to go to the CPA or the accountant and say, "Hey, I have a buyer. The buyer would like the aging." You're not only going to impress the seller, you're also going to do a good job of impressing the CPA because most CPAs that are very knowledgeable in selling know that only knowledgeable buyers ask for things like this. The average buyer doesn't even know what it is.

What I'd like you to do now is let's go back to the page we were working on 4-3 also with the balance sheet off to the side also maybe to the right. We've talked about the accounts receivable and again of the $120,000 receivables, if we find $12,000 are not collectible, how much are we able to subtract from the price we're going to be paying the seller? The $12,000 as long as we get to take those back, he or she.

Going north, the next thing you have up here is a note receivable. Under Notes Receivable of $65,000, I just want to say one thing. In all the years I've been in business, I really don't recall the last time I saw a legitimate Note Receivable because quite often, these are notes made out because this corporation has formed a new corporation and it was a loan made between the old corporation and the new one. The new corporation fails. They still leave the note on the book. How valuable is the note from the corporation that has gone down the tubes? I don't think it's very valuable. So, why not give that back to the seller and lower the price?

The big thing that we run into in this area here on notes receivable and also on notes payable are loans back and forth between the officers, and all I'm going to say is one thing, if there are loans back and forth between the officers of the company and the company, why not just let the officers keep them because we find the owners are doing that either to minimize or avoid paying income tax on profits from the company. So, give them back to them. In fact, I just want to say one thing and that is if you find a legitimate note receivable send me a copy of it. I haven't seen one in probably eight or nine years, maybe ten.

The other thing in notes receivable you have to be careful of is quite often when people are borrowing money from a bank especially on 90 day loans, the bank officers stay on top of their collecting of the receivables because if they're not collecting the receivable, it kills the cash flow of the business and the bank officers worry. Quite often, when an officer in a company is having trouble collecting receivables knowing full well that the bank officer's going to give he or she trouble, what they'll do then is move the receivables that are not collectable into an area called Notes Receivable. If the notes receivables were not collectable as accounts receivables, how collectable are they now? They're not.

I hate to tell you this, you're not going to find many that are legitimate. So, what do you do? Give them back to the seller and lower the price. Why pay that money?

The next thing is cash on hand, and although right now you're going to say, "Well, cash on hand must be legitimate", it normally is, but as you start to get involved in business and find out about things like kiting which are techniques used by embezzlers and also sometimes by business owners to artificially inflate the cash, this could give you trouble in analyzing the business, but if you handle it properly when you're buying it, you end up taking over the amount of money that is really in the bank the day you take over. But, there are different schemes and scams you're going to hear about perpetrated by employees and also perpetrated by owners of businesses, and hopefully you'll take your time and you CPA will cut off the account probably and you will not have trouble with this area – cash on hand.

Next we go to number four in this category and start talking about the inventory. Again, we said here, "How about damage stock? Obsolete stock?" What we try to recommend is use the outside inventory companies. They're listed in the Yellow Pages under "I". You're going to find that they're very good people. They are very professional and they are knowledgeable in the area of the inventory that you are buying or you're selling. You're also going to find the expense is not that high. They're really inexpensive. You're also going to find generally that they're bonded which means if a mistake is made by these companies in handling the inventory or appraising the inventory or valuing the inventory during a transaction, you're going to find they're good for it. They'll make it good.

Why do we try to get you to do this? We normally find that buyers and sellers end up arguing and fighting and kill a transaction if they're together any more than 40 seconds. You're also going to find the average buyer of a business is not as a knowledgeable in the stock room inventory as the seller, and this then puts them on even footing. It gives the buyer a chance in the transaction.

The next thing we start to look at is a thing called pre-paid expenses and we're talking about $15,000 here. The thing you have to realize is when we're trying to buy a company, we are trying to finance as much as possible. If somebody has put up a pre-paid deposit to pre-paid expenses that we may be able to finance, we as buyers would like to find out about it ahead of time to see if the seller would include this in the financing for 10, 15 or 20 years. Or, if they won't do that, maybe we can set up a side note for five years and finance it.

Now, for those of you listening that are representing the seller or the sellers, what are you looking for? All cash. You want your deposits as all cash. Again, as we go through this, I'm going to be switching hats back and forth to show there's two sides of it, maybe three sides. But, the thing to keep in mind is look for win-win situations keeping in mind as I always state that you can make more money in business honestly than you can dishonestly. So, don't try to rip off the other party. It's not necessary.

We also want to mention that things like change and petty cash are not available for paying bills, and also beware of marketable securities at cost. Why? They may be worth less. My gosh, how could that happen. So, be careful in a number of these different areas.

The next category we start to get involved in as we go down below here are the fixed assets, and what we're saying here is the tangible physical facilities utilized by the company in performing it's function. These assets usually represent a permanent investment in special items such as land, buildings – which we don't have in this one, automobiles, furniture and leasehold improvements. In this case here, it's called leasehold expenses.

Now, as you start to look at this and you think about the leasehold expenses, this thing is normally called a number of things. Sometimes we see it down on the sheet as leasehold expenses. Other times you're going to see it down and it will be described as leasehold improvements, and sometimes it will be called fixtures. What we basically have because we have real estate, we have land, we have a building, and then the business owner then makes additions to this. They attach the fixtures. They make improvements called leaseholder improvements. Whether a fixture is a leaseholder improvements, what it normally means is that they are attached to the property, and once the lease is over five, ten, 15 years from now, the owner of the real estate, gets to keep the fixtures and the other. Again, if you haven't covered the lease section, you might go back and review that because we covered that in detail in the tape that has to do with leasing.

When I start to talk about the next category and the equipment value, is it the original cost or the owner's value or the book value, or is it the real value? What do we mean by that? Well, you're going to have to realize there are two basic categories. There's really not four. There's one and two. What happens is I'll find the owner and I'll say, "Look, I bought the equipment for $100,000 a few years ago or maybe $200,000. I now have depreciated or used the ACRS and the equipment now, from a tax standpoint is worth a lot less." And, they have it down at the value of what they paid for it minus what they've written off, and again, it's not accurate.

On the other hand, you're going to find a person that went down to Charlie's Junkyard about a month ago, bought the equipment for $500 and because there's always some inflation, the equipment has to be worth $30-$40,000 today. Neither one is accurate, and what I'd like you to do is go to the people that supply you with the equipment and you're going to find the people that supply you the equipment are going to provide you with an appraisal on the business. They have things just like a Kelly Blue Book that they use in the auto business that lists what the different pieces of used equipment are, and you're going to find they can come back with a verbal or a written appraisal as to what the equipment's worth, and in most cases, it doesn't cost anything. My gosh, it's a free lunch. There's never a free lunch.

The reason they're trying to give you this free appraisal because they want to do what in the future? They want to sell you more equipment. So, find out – why do we do this? Because recently in the last few years because of inflation running higher than normal, we found a lot of the equipment being purchased is actually worth as much or more than what they paid for it, and you're going to find as a buyer, you're going to pick-up a lot of value in this area. You're going to find owners selling their business for $100,000. The equipment alone is worth $300,000. You're going to come back to me 50 times and ask me what's wrong. In some cases, there is some fraud, but in most cases you're going to find you just happen to get a good deal.

Now, on the other hand for those of you who are sellers or representing the sellers, I would suggest right in the beginning you go out and find out what the equipment's really worth because the seller may end up giving away a couple hundred thousand in excess assets because he or she didn't bother going out and finding out what the assets are really worth. So, go out and find it.

The main thing you normally have to watch out for from a buyers standpoint or somebody protecting a buyer are the seller's don't at cost and what they do is they keep adding to the value. They may have it down at what it's worth today or replacement costs, and most of these approaches like replacement costs end up artificially inflating the value. So, it is possible that you could end up with a value on here that's a little higher. So, check it out to find out how the seller arrived at it or talk to the CPA or accountant, and beware, take your time.

As we start to go to the next category, we start to talk about a thing called intangible assets. Now, these are very difficult to define because in some cases they represent definitive money value while in others they don't have a measurable cash value. Examples are organization expense, patents, franchises, goodwill.

Now, a patent and a copyright have a limited life. Again, a patent has a limited life of about 17 years. A copyright today is basically 50 years or the life of the owner plus

50 years. Trademark is good forever, and again I already said patents are good for 17 years.

Now, looking at this here, we find we have a patent value and the patent value is $25,000. You say, “Hey, $25,000.” This example probably isn’t a very good one because most of the time we find that the owners have not put on the balance sheet the value of the patent based on what they paid for it, but it’s the value that they as the inventory have attached to it. In this case here, $25,000 would not throw off the value or the purchase of the business very much. What happens if you have a business like this and the owner has a total net worth of $220,000 basic and then on top of that there’s another four million dollars of patent value? You’re going to find you’re going to have a hard time putting a transaction together as buyer or seller, and whether the patent value happens to be $25,000 or it happens to $200,000 or a million dollars or two million, what we try to do when you have a case like that as a buyer or an agent for the buyer, we try to have the seller keep the patent and the seller giving us rights under a licensing contract.

Then, instead of having to pay the $25,000 or two million dollars for it, we pay them .02 cents per part produced or sold. Again, I just made up that number. What it is it ties into what you’re doing. Also, if you decide not to distribute or manufacture that product later, you don’t have to pay anymore on that patent. It also is a win-win situation because not only does a buyer win but the seller wins because the average seller that has developed something or has developed a patent – a patentable item – is usually a person that is very attached to that, and this way they keep ownership and they keep all the plans and blueprints. They can keep them under their bed.

The next thing we’re talking about here are miscellaneous assets or on the balance sheet we’re talking about other assets, and they’re identified by the process of elimination. If they don’t fit in other categories, place it here. Items in this category are cash or undervalued life insurance, deferred charges. Again, sometimes different categories are prepaid expense. The prepaid expenses we have in this example happen to be things that are coming up in the next few months. So, they’re not long term.

A prepaid asset, can you use it or is it worthless? Example, stationary with an old business name, and in our example here, we have prepaid paper there’s a $5,000, and the thing that always fascinates me are paper goods because I can usually walk into the back of a business and tell how many former owners we had by the number of skids with stationary in corrugated boxes because everytime a new owner comes in and the stationary in corrugate boxes are green, the next one’s going to want yellow. The next one’s going to want purple, black, and so on, and if you go back there and find five different colors it normally means you have five or six different owners, and what I do is I try to get rid of that.

When I’m buying a company or representing somebody, I try to get the seller to buy it and keep it, sentimental value – ten cents on the dollar or whatever. If they don’t do that, I deliver it to their garage. Why? There is not one seller man and wife that do not love to reminisce if they’ve owned that company 15-20 years. That way I deliver all the corrugated boxes and stationary to the garage. That way on the weekend when the grandkids come over to visit grandma and grandpa they can take them out in the garage tell them about their past days owning the company, put together two corrugated boxes, fill it with old stationary, and send it home to their kids. And, actually the kids then after a few weeks don't want to send them to grandma and grandpa's house because of all the junk they bring back.

The next thing we start to get involved in is a thing called the liabilities, and if you'll flip to 4-7 we're talking about current liabilities and those are obligations that mature within one year of the closing date of the financial statement. It include the demand note which have no fixed maturity, accounts payable, notes payable, tax liabilities, accrued items.

Now, the first thing we have here as we look at is a thing called accounts payable and it's $115,000, and what we're saying is let's age the accounts payable. Well, what does that mean? Well, let's turn to the last page in this section, the one right after the aging of the accounts receivable, and either pull it out or just look at page 4-15 which is aging of accounts payable. Now, what we're going to do, again there forms are available from stationary stores in pads of 50 or 100. They're not very expensive. You don't have to make up your own. What we've done here is we've given you a cross-section of the accounts payable. We have a list of them because the accounts payable do amount to $115,000. We've given you five of them.

We have Ace Hardware, and we owe them $4,000 and we're current, but, as we get down to Bill's Deli, we find that there's $5,000 owed, and $4,000 is current and $1,000 past due. You're saying, "Well, why do we want this?" Well, one good reason, when you're buying a company would you not like to know if they're paying their bills or not especially when an owner is telling you that the statement doesn't show what they're making or making a lot more. You then go to the aging of the accounts payable, and what you find lo and behold, they're not paying their bills either. What it usually is a reflection of is there's a problem in the business, and they're past due and you might as well find out about it ahead of time.

Now, also when you're talking about an aging and you're going in as a buyer, if the owner will not give you a list of his suppliers that they have, what we quite often do is ask them for an aging of the accounts payable. Now, what we end up doing is getting that.

Now, for those of you listening that are sellers or agent for the sellers, what I suggest you do, and again you don't have to give this information out before the offer is made and it's accepted, and be careful when they ask for the accounts payable. Incidentally, if you are a small seller and you've been around a while, you do know what they're asking for. They're trying to get the information ahead of time.

Now, as we start to talk about the payables, what I'd like to do is take you back to the first section again, or page 4-9, and also take you back to the section that has to do with the liabilities which is on 4-7. So, you should have 4-7 in front of you and also 4-9.

Now, we talked about the aging of accounts payable, also on the notes payable wouldn't you like to make sure that the notes payable have been paid. In other words, we owe money in this company, wouldn't you like to make sure they're paid and they're paid on time?

How about taxes due? Are there past due taxes? In another section of the program, you're going to find one of the problems we have. Now, with a sole proprietorship you're going to find in buying or selling a business, we end up with the hang-ups or the problems that we have on taxes. In other words whether the taxes have been paid or not, whether there's been fraud. You're going to find out later, we do have a problem we get involved in an area called appropriations because unless you dissolve the corporation during the escrow or closing period, you're going to find that you as a buyer end up buying the stock and maybe the assets, but if you buy the stock and don't have the benefit of a bulk sale, which we're going to cover later, you're going to find out that you end up taking over the taxes unpaid. You also end up taking over all the fraud. We'll show you later in the program how to resolve that problem and how to handle it properly.

Let's continue on here. Are there mechanics' liens on the property? We're going to show you how to check those later. Are there notes past due? We've already talked about that. Again, in the area of the liabilities, check these very carefully and also go through the different protection devices that we show you later. I don't care what state you work in, do not let anybody talk you into waiving your rights under the law because what happens is many of you as buyers end up speeding along in order to speed it up by five days or ten days or three weeks, and you end up getting ripped off in the transaction. So, later as we show you the protection that we have built into the program for buyers and sellers, why not follow them. Take your time, and go through the various steps.

LESSON 5

In this section on pricing, we're going to get involved in the actual pricing of a business, a manufacturing company, and you're going to find that a lot of the basic things that we use in manufacturing in the future, you'll find will also apply when you go out and price a retail business, a service business or price a distributorship.

Now, the thing I want you to realize as you go through this section, we are not going to make appraisers out of you because it takes a lifetime to become a business appraiser. What we want you to realize we're going to be teaching you how to price a business.

Now, I want you to realize this program was developed by us many years ago. We have tried it for many years, and it works very well. The different offices that we have around the United States that are in the brokerage area where we list and sell businesses or do merger and acquisition also use this as a guide in pricing businesses.

One of the reasons that we developed this a number of years ago was because one of the biggest hang-ups that most buyers had when they were buying a business, they though they were paying too much. Sellers were selling businesses and thinking they were not getting enough money, and then we had our broker friends and consultants and attorneys and CPAs that were out there trying to price a business for their clients and found it was very difficult.

So, what we tried to do is come up with a mathematical method for pricing or arriving at a price for a business, and you're going to find if you apply it, you're going to find that in the beginning it's going to take you a little while to get it down pat, and by the time you've done it seven or eight times, we find that the average person can price at a business in about ten minutes.

So, let's get started, but let's go back and start talking about the past. We start thinking about the past years ago when we first started, we had a lot of rules of thumb, and what we had was we had a number of people out there that did not know a lot about business, and so what they needed was something to give them a magic way of arriving at a price. One of the things that were used quite a few years ago, and used quite infrequently today is a thing called the gross multiplier.

In a technique like this, a persona analyzing a business, would take the annual sales of the business, multiply it by this magic number they had arrived at by some mumbo jumbo, and then come up with a price. The only problem with this is this is not taking into consideration things like the profit, the location, things like this. These are all things that go into the value of the business or how much money it was making.

The next method that we run into is a thing called the net multiplier, and a net multiplier, you're going to find that the people analyzing using this method are taking magic numbers and multiplying by the net profit of the business to come up with a value. Although this does take into consideration a lot of the cash flow items of the business, it doesn't take into consideration, again, the value of the location, the value of the management team, the value of the employees, the consideration for how much financing you can get. So, there was a lot of considerations this does not take into consideration.

Net multipliers are still used to a large degree around the United States by a lot of people that have been in the business ten, 15, 20 years, but the thing we want to warn you on, if you decide to use these, you're going to find they are not very accurate, and in most transactions either the buyer or the seller ends up getting shafted. So, although some people may use these as a guide, what we'd like you to start doing over the next couple of years is get away from these techniques because of the technique we developed now, you don't have to use these magic multipliers.

Now, this thing we're going to be talking about on this tape has to do with a thing we call the Hamel Method because although we have these magic methods for arriving at a price that were used for many years, and as a matter of fact, I taught a lot of these over the years, I want you to realize, the thing we had trouble with about six or seven years ago in this country was the fact that we couldn't get a lot of buyers to get involved in business because they had this great fear as to what the price was or whether they were really getting a good deal or whether they were getting a bum deal.

All we needed was something that was simple, something that somebody could use that was doing this everyday, something that was very accurate, and also something for somebody that maybe wanted to price or evaluate a business every two or three years. We needed something basically that was something for a dummy you might say.

So, what we developed was the Hamel Method, and what we really did is we went out and worked with business appraisers all over the United States, and working with the business appraisers what we did was we sat down with them, we found out they had done it from the state of the art standpoint, how they evaluated businesses, how they were able to analyze the hard value assets, how they went out and analyzed the intangibles, the goodwill, blue sky, whatever you want to call it, and what went into that subjectively.

Now, you have to realize most of these business appraisers had ten, 15, 20, 30 years experience and they're using this experience to arrive at a value. They had guides they used, and all we did as we sat down with them over a period of a couple of years – we set up mathematical equations, and what we have done then is taken what is basically state of the art a few years ago, applied mathematical equations to them, and today what we have is a mathematical system, and all you're going to have to do as you go through this program on these tapes is figure out what describes the business you're looking at and using appropriate number. By adding up all these numbers that you end up with as you'll find later in the tapes, you're going to end up with a thing called a price of a business, and lo and behold, believe it or not, you're going to find as you go out in the real world, you're going to find these numbers do hold up and you're going to find that you're going to be able to buy a business at this level or sell at this level.

The only time that we have problems even today in our pricing versus the real world is an area of service businesses, and you're going to find in many cases when you're using this pricing system, our price or value will come up to a value I wouldn't say a lot less, but substantially less to a medium less than what the people are asking for the business, and what I'd like you to suggest is we've already verified this area. And, what we have is you are now going to get involved in a system that measures a service business accurately.

What you're going to find in the real world as you go out in the service area, you're going to find that service businesses are basically overpriced, and since they are you're going to find that you're going to have to get involved in more negotiation to get the price down to the right level.

As you go through this system also we'll do on the tapes, you're going to find that there's a number of things that are going to be exceptions. When we first set up this program mathematically, we set it up to cover maybe 98-99 percent of all the things you're going to run into, but you have to realize because of the variations in pricing, and also the variations in types of businesses you're going to run into, you have to realize that you're going to have exceptions.

You're going to run into things that are going to give you trouble. You're going to have to go to somebody that is more expert than yourself. It doesn't happen very often, but when you run into problems like backlog you're going to have to have some help in measuring the affects of backlog on the value of the business because let's face it, if you have a company with a backlog of orders of only $100,000 that company is not worth as much as a company that has a backlog of maybe $500,000 or a million.

Other things you're going to run into will be things like special contracts. The company will have a special contract. They'll have a special tie to a company. That gives that value also. Why? Because they have a basic market that they have control over, and with that control over that market, you're going to find that gives them basic sales and profit every year, which again adds to the value.

The last thing, and by no means the last thing, but the last thing we'll be considering today is this thing called the exceptional year, and we seen it recently in the automobile business. You see it quite often in real estate related businesses where you have extreme peaks and valleys, and you'll see gradual growth. The company will show sales the first year of $100,000 and then $150,000, then $200,000. Again, the profits going up at the same approximate level. All of a sudden although in the last year they had $200,000 in sales and maybe $50,000 in profit, the sales figure will suddenly jump from $200,000 to $800,000 and the profit will jump accordingly.

Now, the thing you have to realize is do not get trapped into pricing or valuing the business just based on that one year. One of the techniques used quite often by a lot of people is to take the average of the last three years. Others of us in the business, if you happen to have a business that has more than five years cycle, it could be the automobile business with six or seven years cycle. We will then take the average of that period of time. Please keep this in mind or you'll have a tendency to grossly overprice or grossly underprice the business you're looking at.

Now, let's get started now because if you're been following me on page 5-1, what I'd like you to do now is turn to page 5-3, and what we're going to have you do now, is pull 5-3 and 5-5 out of your book. Please pull those out of your book.

Now, what you have here is you have two different documents that are going to be describing a company called, "M Manufacturing", and on the first part of the pricing that we're about to go into, you're going to find there's two documents that you need for analyzing this business from this side.

Now, in the first part we're going to be analyzing a thing called hard value assets. Now, on M Manufacturing, the first thing you see on page 5-3 is the Profit and Loss statement. Now, early in this cassette program, we went through the Profit and Loss statement. What we're going to do now is take you through the Profit and Loss statement again, and show you how we use the Profit and Loss statement information to price or value a business. The other thing we're going to be using in the area of hard value assets is a thing called a Balance Sheet, and what you have is the Balance Sheet here for M Manufacturing Company.

So, if you'll just set these two on your desk or table, set these aside so you can refer to them, what I'd like you to do also then is turn to the page in your book 5-9. Now, 5-9 is the actual pricing sheet and a sheet that we're going to be using as a guide in this section, and what we're going to be doing now for the rest of this area, we're going to be covering a company called M Manufacturing. We're being covering pricing or the valuation of the hard value assets and then the Hamel Business Values on the other side of the sheet.

Incidentally, the Hamel Business Value is nothing more than the measurement of the intangibles. You can call it goodwill or you can call it blue sky. And, we'll be covering that a little later.

But, let's take the first part of the sheet first which is page 5-9, and what we've attempted to do for you here is we have broken this sheet into five section – Section One, Section Two, Section Three, Section Four and Section Five. What I'd like you to do now is start with Section One, and you'll see up in the left hand corner on this sample sheet you have here, we have Section One.

Now, Section One which is the total thing which starts in the upper left hand corner, and it says total sales down to the last item in Section One which says net profit. We're now going to put in here what we call the summary or summation of the Profit and Loss statement. We will have sat down with the owner or if you happen to be the owner of the business. You'll take the Profit and Loss statement usually for the last year that you have.

Now, if you happen to be in the middle of the year or toward the end of the year, what I want you to do is take the statement for the end of the last complete year that you have, and then later on in this program, I will show you then how to take the items that you end up with, and adjust them up to the next level or downward.

Let's start off by talking about the M Manufacturing Profit and Loss statement. First of all, in the last year, year 198x, we had sales of $600,000. So, under "Sales" in the first area, since we're all going to be making up a summary, what I'd like you to do is put down the $600,000. That's the sales for last year.

Now, what we'd like to do now is we're going to subtract this Cost of Sales because in order to have the sales of $600,000 what we did is we took materials on the second line of $150,000, we added labor of $200,000. Now, when you take the materials and labor and add those together, you get a total cost of sales. In other words, the total cost of the product that you manufactured for resale was $350,000.

The one thing I'd like you to keep in mind as you look at the labor in this area is the fact that in the labor area, this is the labor that we call direct labor, and this is the labor that goes directly against the product. If you would go back to the Profit and Loss statement on section 5-3, you would notice on Operating Expenses, that we also have in here a thing called Payroll, and I believe the number is $20,000.

Now, the $20,000 in payroll that you say in Operating Expenses on page 5-3 is the actual overhead, your office expense. These are the people that are working in your office.

The labor figure that you see on 5-9 under Cost of Sales which is a $200,000 labor figure are the people working on your production floor, and their labor is directly tied into the product.

So, what do we have under Cost of Sales when we're in a manufacturing company? We'll have materials – in this case $150,000. We add to that some labor, and we end up with a product that costs us $350,000. We then take the products during the year that cost us $350,000 in our shops, and we go out and sell them for how much? For $600,000.

When you get involved in businesses like a retail business, in a retail business we would not have labor because what we'd be doing basically as an example is we'd go out and buy a woman's dress. We'd buy it for $100. We'd mark it up then to $200. The cost of sales would be what? $100 or 50 percent.

Now, the thing you have to realize is in an area like that what do you not have? You do not have labor.

Going the next step, you're also going to be running into businesses called service businesses, and when you get involved in service, what are you selling? Your labor, and you're going to find in a business like that, you don't have material and you don't have any labor that you add to the material. So, when you're in a service business, you're going to find the cost of sales area or cost of goods area is going to be left blank.

As we subtract Cost of Sales now from the Sales figure, we end up with a gross profit of $250,000, and the reason I mention this, and we're going to mention it over and over again in this program, we're trying to help you become familiar with the different terminology used in the industry.

Now, once we have a gross profit of $250,000, a lot of you say, "Oh boy, we're going to put the $250,000 in our pocket." Well, that's not true because we're going to find that although we have the expenses from the manufacturing area subtracted out, we still have a few other problems. We're going to have to subtract other expenses from this businesses to end up as you're going to see here with a profit of $100,000.

Now, on these pricing sheets from here on out, we could have just taken the expense and just lumped it and ended up with a profit of $100,000 on this summary, but the reason we isolate a couple of things here is because of problems we have in analyzing businesses.

Now, first of all, what we're trying to do is isolate expenses that we have trouble with, and the first one is a thing called a manager's salary. Now, the manager in this business is being paid $40,000 a year. The owner does not work in this business. So, all we have is a manager. The manager's running it. The manager's paid $40,000 a year, and the owner of this business stops by occasionally. He don't have a major thing here.

Now, what we're trying to do – we've got to get back to the basic area. We've already talked about this before in the area where we covered the Profit and Loss statement. The only way you're going to be able to analyze a business effectively and compare apples and apples is you have to be able to analyze a business that shows a bottom line net, in this example of $100,000, after you have done one thing which means built in the manager's salary and then pushed back in all of the owner's perks and benefits. If you don't do that, you're never going to be able to compare apples and apples because one business owner will be taking out $20,000 for themselves. Another business owner pulls out $50,000. Another business owner pulls out $100,000.

Unless you can get back to the point where each business has been reconstructed so that we have taken the owner's perks and benefits and pushed those back in to adjust the profit and loss, and we've also backed out whatever the manager's salary is, you're going to find that you can't compare apples and apples.

So, what have we done here? We've isolated it. If you run into a sheet like this in working with somebody selling a business, buying a business, or even at a marketing session and the manager's salary has not been filled in – I just want to warn you – beware. Somebody hasn't done their homework or the numbers are not very accurate. In other words, you're going to be comparing apples with the Jupiter effect.

The next item we have here that we're trying to isolate is a thing called Building Rent, and the reason for this quite often when you're buying a business, there is real estate attached to that business, and what happens is the owners from the old school that don't have good CPAs or good tax advice will have their business and their real estate within one company. What will happen is if they pay off their real estate and end up depreciating or taking the ACRS on it, you're going to find when you look at the profit and loss statement, there is no expense or there are no expense items that reflect the ownership of the real estate, and what will happen is after they paid off the real estate, there's no interest write off.

You're also going to find after they've taken all the tax write-offs they can, there's also no depreciation or ACRS. So, what do we find? The owner's going to be telling you they're living rent free, and the crazy thing about it is here's a business that shows $100,000, and although we're paying rent – let's take an example where the owner owned the building. He was paying no rent to himself, and living rent free. You're going to find a lot of examples like this where the owner could take the building that he owns, go down the street, rent it out for somebody else for $200,000 a year.

Now, if this business had to pay $200,000 a year rent, it would be running in the red. In fact, what you have here is a business that really doesn't makes sense if you have condition. Why? Because if you could re-rent it to somebody else for $200,000, what you should do is close down your business, sell off all your assets, and rent it out to somebody else. Why would you want to make a $100,000 a year on a business and work a lot of hours, when you can close it down, rent it out to somebody else and make even more money than that? You're going to run into this quite often. So, don't be surprised.

Now, in this example we have a different situation. We have a building rent. They're paying a building rent of $10,000, but the reason we isolate that is the classic example that I've run into many times is you're going to find the owner is living rent free. You then decide to go in, and you take over the business. You decide you don't want to buy the real estate now, and you want an option to purchase.

So, you then sign a lease and pay $8,000 a month. The thing is you're paying $8,000 a month. You then come to me at the end of the year, and say, "Gosh, Art, I can't figure this out. The other owner was making $100,000. I feel I'm only making $4,000." You really are because you forgot to take into consideration the lease payment you're paying that the former owner wasn't paying.

Now, when I isolate these areas, I want you to realize because I'm not bringing up exceptions. I'm bringing up things that happen everyday all over the country. So, I want you to concentrate on these because this is where you make the most mistakes.

Now, the next area, the thing we call "Other" is only put in here for those of you listening to this that are nit-pickers, because what you want to do is have everything balance out. The Other is just put in there to balance out all the total $150,000 of expenses. After you get working on this I really don't care if you fill out that line. All it is, is a balancing effect to give us total expense of $150,000.

If you want to know where we got the total expenses of $150,000 from, if you go back to your Profit and Loss on page 5-3 under Operating Expenses, you'll see that we've given you a break down of all of the expenses that do make up the $150,000.

Now, if we now subtract the expenses that we have, and the gross profit we talked about, son of a gun, guess what we end up with? We end up with the net profit of $100,000. We're on our way. Now, all we've done, and again, you're going to say, "Gosh this might be confusing." All we've done is we've put down here a summary of the Profit and Loss Statement so we can refer back to it when we're doing it, and as we go on here you're going to see that we're going to build on this. We're going to build on the Profit and Loss statement we have here.

Now, we've basically covered section one, which is nothing more than what? The summary of the Profit and Loss statement. Now, as we start to go south or down the sheet into section two, we're going to get you involved in an area that we call "the adding back of the owner's perks and benefits."

I'd like to describe perks again. Perks we're calling the thing called perquisites. In other words, they are actual benefits that the owner takes out of the business that the owner is able to take out tax free. Now these are things you're going to build back in. Why? Because unless we do this, we're not going to know what the true profit of the business is because in this example here the business shows a profit of $100,000, but as you're going to find out there are additional items in here that are either you would call a paper write-off or maybe write-offs that the buyer is not going to take. But, the thing is we have to realize we have to analyze this business with $100,000 as this business shows plus we have to build back in all the what? All the benefits and perks the owner is taking out because if you're going to price a business in the United States today, you can price it on what the Profit and Loss says.

As I already told you in this program, the average Profit and Loss never represents what the business makes. All it represents is the lowest Profit and Loss for tax purposes, and so what we have to do is build back in the items to find out what is the little jewel really making.

Now, one of the first items that are going to go back in here is depreciation. If you look at 5-3 under Operating Expenses, you'll see the other owner has subtracted a thing called depreciation. In the new tax laws, this is called ACRS – accelerated cost recovery system. What we're doing is the government is allowing us to write off certain amounts of the personal property we have in the business. Again, in this example here we don't real estate so it happens to be depreciation or ACRS on the personal property in the business.

Last year, the owner took $30,000 depreciation or ACRS. Now, that's very interesting, but the thing I want you to realize we're going to be building this back in. Why? Later on as we get down to section four, we're going to then actually take into consideration the real depletion or the wasting of the equipment you have.

Right now, the deprecation or ACRS or the tax write-off that you have on your personal property is based on tables that the Internal Revenue has established, and you're going to find that sometimes it does adequately represent the amount of money you're going to have to put in to replace that equipment, and with the inflation we have today, you're going to find a lot of times it doesn't quite cover it.

So, what we're doing is we're pushing it back in. We're building it back in, and you can say if you want to it's a paper item, but it doesn't make any difference because what you're doing is pushing that back in because below in section four, as we continue on the price, you're going to find that we're going to make adjustments or figure returns on the same equipment based on the real wasting or what it really costs us. In other words, we're not going to use government tables. We're going to find out what the real number is, what the real world is. So, build back in the depreciation.

Now, the next item we're going to build back in is a thing called interest, and I'd like to state this now and I'll state it again later. When you're going to price or value a business, the thing you have to do is value that business free and clear. If you don't do that, you're going to find that it's going to be very confusing because although it shows the position of where the seller is right now and how much financing they have, you also have to realize that this business is being priced from the standpoint of the buyer looking at it, or the buyer being willing to buy it.

So, what we have to do is analyze this basically free and clear, and after you have analyzed the actual value of the business, then you can tie in what the financing is and what it does to the cash flow, but what you have to do basically here is go free and clear.

So, what do we do? We take the interest payments that have been paid and we push this back into the business because the interest payments that have been paid by the seller will not necessarily be the same interest payments that you have, and if you're the buyer and you're looking at it from that standpoint, you want to be able to look at this manufacturing company from all different sides to see the same picture.

So, what do we see? We're pushing back in the interest. We're pushing it back in so we'll make it free and clear.

One of the next items we have is something that a lot of people are not aware of, and very few people ever take into consideration, and that's called a non-recurring expense. In this business in the last year, they had an expense of $10,000 that came up on time. If you don't build this back in, what you're going to find is you're going to be pricing the business based on a condition that only happened once. You have to price the business based on what the normal conditions and operating parameters are.

The other thing is and we don't have this in this example, you better beware of another thing called, "non-recurring income". You may find that you are doing work – sheet metal work – and normally every year you have certain jobs. In the last year, you may have found that you had one large job that's not going to come back again and it's the thing that took you from $200,000 in sales up to $800,000. Why did this happen? Because we had a single item that's not going to occur again, it's non-recurring. You have to be careful number on not to price or value the business on a non-recurring large amount of income, and also beware especially of a thing called non-recurring expense, and how are you going to dig you this out? We're going to be showing you this in this program.

As we add up these different items, these different items come to $50,000 which means we end up with a real net profit of $150,000. As you go out into the real world as we've discussed earlier in the tape, you're going to find the number that we have here is really on the low side because we have found, and again not taking the example of $100,000 – I'll restate what we talked about before. We run into a business owner paying tax on $50,000 we usually find there's some additional perks and benefits in the range of $100-$150,000. The more profit that the business pays tax on, the more perks and benefits we generally run into. So, don't be surprised at the large numbers, just go in and do your homework and build it back in.

Now, when we first started we had a business here that showed a profit of $100,000. We now have gotten it to a point building things back in where we have a profit of $150,000, and on this we're going to start to base the value of the business.

Now, before we go any further in this area on the profit, the thing we have to start to tie in now at this time is page 5-5, the Balance Sheet. In other words, the Balance Sheet is the thing we already discussed in this program, and what we're going to be talking about are the hard value assets of the business because the two basic things that make up a business is A-hard value assets – the value of the cash, the accounts receivable, the inventory, the equipment, all the things like this. These are hard value items. These are things you can go out and touch, put your arms around, hold. It's easy to give values on. Buyers and sellers don't disagree on these very often. Again, the disagreement is a lot less than you have in the other areas.

The other thing that makes up the value of the business and there's only two basic things. One is hard value assets, and the other things are the things that you hear about and you probably call them goodwill. You call them blue sky, or you can call them the intangibles. And, again, we'll get into the second part of this later in the program, but let's take the balance sheet now because one of the first things we have to analyze in this first sheet here on this first side is what are the hard value assets? What is the buyer getting when they buy this business? What is the seller selling? What are the basic items of equipment, hard value assets?

Now, let's start with the first on here, and look at the first asset, and it's called Cash on Hand. That's the amount of cash that this business had in the bank or on hand in other types of accounts that day which happened to be December 31st, 198x.

Now, keep in mind we are pricing or valuing a business at a date other than the date we're buying it or selling it. We're also pricing this or valuing it based on numbers that are not going to be the same numbers the day we take over. So, keep that in mind also. We'll talk about that later.

Now, first of all in cash on hand, we have $50,000. now, as you put it on the sheet under value under assets, remember we're putting down the assets that you are going to receive when you're buying the business, or if you're the seller, these are the assets you're passing on to the other party the buyer. If the first item is a thing called cash, that means the buyer gets the cash at the close of the transaction. Now, you're saying, "Why would anybody leave cash in a business? That doesn't make sense." Well, later on we haven't gotten to that, but as we turn over the sheets we're looking at right now, you're going to find that you're looking at a corporation. In fact, if you'd like to right now why don't we just take one of the sheets and flip over 5-3, and look at 5-4 and up in the upper left hand corner where it says Business Opportunity Owner Summary Statement in the left hand area the first thing it says is company name, business name – M Manufacturing, M Company. The type of business is manufacturing, and it says the business form is what? It's a corporation.

We've already talked about the different forms of ownership earlier in the program. What I'd like to do now is talk about another thing we haven't discussed yet in the area of corporations. When a business owner has a corporate form of ownership, you're going to find over 50 percent of the time the owner will leave the cash in the corporation when they leave.

Now, let's explain this because there's no free lunch in business. The reason the owner leaves the cash in the corporation is they usually have sat down with their CPAs, accountants or tax advisors and the tax advisors have said, "You have two ways to go when you settle this company. You can sell the assets and liabilities to the person buying it, or you can sell the stock, since it happens to be a corporation. If you elect to sell the assets and liabilities, you're going to have pay capital gains rates on part of it, and unfortunately ordinary income on part of it." That's not too good for the seller.

So, what happens is the seller will say, "What else can I do." And, the CPA or tax advisor will then say to the seller, "Why don't you consider selling the stock? If you sell the stock, you'll pay capital gains on the total gain of the stock and you don't have to worry about the ordinary income." That's the good news.

What you're going to find then is as soon as the person elects to go with the sale of the stock, they will find that if they try to pull cash out of the corporation while they're doing this, they're going to be taxed heavily. So, what would they rather do? They'd rather receive cash for their stock, and the leave the cash in the corporation. Why? It's beneficial to the seller tax wise. There's no free lunch. You're doing it for that reason.

Now, the other I'd like to mention at this time, this happens to be a corporation, and again over half the time they'll leave the money. How do you find out if they'll leave it or not? Ask the seller. They'll tell you.

Now, the other form of ownership you're going to run into and they'll be like this is a thing called sole-proprietorship. Not in this example, but when you run into the sole-proprietorship, you're going to find that the owner has no reason to leave the cash in. Would you like to make a guess to how often they're going to leave the cash in there? Never.

Now, again, if they had one that had $50,000 cash in it and you gave them $60,000 for the cash, they might leave it in, but again in all the years I've been doing this, I've never seen an owner in a sole proprietorship ever leave the cash. I'm sure I never will. So, you don't have to count in it. But, in a corporation, ask and you're going to find in many cases you're going to have $50,000-$100,000, whatever the amount happens to be. But, do ask right in the beginning.

The next asset we have on the second line or if you're looking at your balance sheet, is a thing called accounts receivable. We've talked about this already, but let's review. Accounts receivable means that people have come in to the business that the owner has here and says, "I don't want to pay cash. How about some financing?" The financing becomes a thing called accounts receivable, and what you're going to find here is you have accounts receivable of $150,000. You're going to say, "Well, is that significant?" Of course it is.

You have a company here that only does $600,000 a year in sales and you have taken $150,000 of your assets, and you let somebody borrow it. I mean, you're in the financing business. In fact, you're almost more in the financing business than you are in manufacturing. I'll tell you something, $150,000 of financing of money of yours as an owner that you have to put up to finance things is horrendous. It can sink you company. In fact, these are things that sink you when you have bad times. In fact, they'll even sink you when you have good times.

What I'd like to do at this time, if you'll just consider the receivables are $150,000, and $150,000 of receivables are choking you because you're in the financing business. You have a financing subdivision. How are you going to take the pressure off? What I'd like you to do, and again, we're going to go a little out of line. We're going to cover everything. I'd like you to go down under liabilities, under current liabilities, and there's a thing there called Accounts Payable. And, if you'll also look at your sheet 5-9, your pricing sheet under liabilities you'll see Accounts Payable of $100,000. Now, what does that mean? That means that when we get involved in this business, if you happen to be the owner, you're going to find that although you have the big hand on your neck strangling you with $150,000 of accounts receivable, on the other hand you have good news, and the good news is that you're going to have suppliers and vendors come along with people that you're doing business with – friends of yours, co-business owners – and what they're going to do is provide you with financing. Again, they love to have cash, but a lot of them are going to allow you to pay in seven days, 14 days, 30, 60, or 90 days, and what this does is release the noose or the fingers from your throat, and how much has it released? $100,000.

Now, what you're going to find then if you want to keep business very simple, you're not in the financing business for $150,000. You're only in the financing business for the difference between the accounts receivable and the accounts payable. So, how much are we being strangled by now? $50,000.

You're going to find as we go through this program we're going to be teaching you, number one, you are now in the financing business for $50,000. What happens if we're going to be able to show you to balance out the receivables and payables? Who's in the financing business then? No one. Supposing we're able to show you in this program how to make the payables larger than the receivables. If the payables are larger than the receivables, who's going to be in the financing business? That's right, the other party, and you're going to find for every dollar after you take over a business that you put the other party in the financing business, you will have one more dollar in you bank account that is yours to spend and use as working capital. Although a lot of you think this is done with mirrors, as we get into the sections in this book that have to do with financing, we're going to show you step by step how to do this, and once you do this, you're going to find this is going to help you with a lot of your cash requirements, you're working capital requirements, and you're going to have this financing available to you in your business at no cost.

Now, how is this going to help you? Number one, all of your competitors are going to be out in the financing business. You're going to find if you listen to what we teach in this program, the other parties going to be in the financing business, and when push comes to shove and you get involved in a recession, you get involved in a depression, you're going to find that the other people are in the financing business, and you on the other hand are going to have their money in your bank account. He or she who has the money in their bank account is who survives. We'll show you that again later.

Now, one last thing, I always forget to do this on the accounts receivable. We mentioned this once already, I want to mention this again because in this tele-program, I'm going to mention it four or five or six times because it's very important. In fact, I consider the receivables and payable two of the key things for buying, running, or getting involved in business. I don't care if you want to own a little donut shop or you want to buy General Motors. You have to understand this because this is one of the basic things that make up a thing called the cash flow. Again, I'm not talking about the bottom line cash flow. I'm talking about the way the money flows through the company.

Now, when you start to get involved in accounts receivable, a lot of people are going to tell you when you're selling your business, they want to keep their receivables. They're going to tell you they want to keep their payables. As you get involved, I want to tell you most of the time, you want to take over the receivables. As you go through the rest of this program, it's going to become apparent why you want to do this because some of the best financing you're going to find is available in this area.

Now, the first thing is on receivables, there are going to be accounts receivable and not collectable because when you're in business and people owe you money, some of them pay you on time, some of them pay seven days late, 30 days late, 60 days late. The later the time becomes the less chance you have of collecting. So, what you're going to find later in this program is we're going to do a thing called aging. In fact, we've already talked about it once in the area of balance sheet, and what we're going to do is we're going to take you through a thing called aging, and again, aging means that we actually list the different accounts receivable in this company. We actually analyze those to see if they're current or if they're past due, and what we try to do is not buy the ones that are past due. Again, we've already talked about the exception to that.

Now, since we're only buying the goods and letting the seller or former owner keep the other ones, the next step we go to – we'll be talking about this later – in the offer to purchase, when the buyer buys it, we also build in a paragraph that state that the seller guarantees the ones that you're taking over, and the seller not only guarantees, but the seller will allow us to subtract the amount that we haven't collected from the next payment that we make, and you'll see this later in the program.

Continuing on now, we're talking about the next category and the next item on your balance sheet, and we're going to talk about a thing called Inventory. Again, this is another area that we talk about a number of times. In other words, we're going to go through inventory a number of times over and over again.

Now, on the inventory. We're talking about inventory cost of $50,000. In other words, the person that owns this business went out and bought this inventory, and they're reselling it to you at their cost.

Now, you're going to find that this is what most business owners do. What you have to do is beware of those business owners that want to sell you their inventory for what they paid for it plus 50%. If they do, I want to ask you a question, are you paying wholesale or are you paying retail? And, incidentally, we don't see this very often in larger companies, but in smaller retail businesses, businesses that are Mom and Pops making under $50,000 a year net, we find a number of business owners do this, and what they're doing is they're trying to show their first profit they've ever shown in their business by ripping off the buyer. So, what we're saying is we normally buy it at cost.

We've already mentioned this before when we were going through the balance sheet, but let me restate this. We very seldom take this inventory because when buyer and seller get together to take inventory, if it takes more than 40 seconds, they tend to fight. So, what we do, and again I'm repeating what I said before, we like you to use and we recommend that use the inventory companies. They're listed in the yellow pages under "I". They come out, and they do a very nice job. They're professional in these areas, and their cost is not very high.

I want to repeat one thing when you use these companies. They're also bonded which means when a mistake is made, they will make it good. And, why do we do this? I'm restating a point – the buyer, I don't care how sharp they are in the business, are usually not as sharp on the inventory as the seller. This, then, gives the buyer and additional edge because they have this group in there that knows that inventory or they're taking inventory very well. If a mistake is made then, the people that have taken the inventory will make it good. They will cover whatever mistakes they have made. So, it's a good way to go. So, we're buying the inventory generally at cost.

The next thing we run into here getting out of the current asset area, is fixed assets, and if you're looking at the next item on your pricing sheet or on the Balance Sheet on 5-5, the next item is the equipment, and what we have here is equipment and it's priced at $40,000. Now, when you start to look at equipment, what value are we using because a lot of people are going to come to you and say, "Use a book value." You're going to say, "What is a book value?"

Well, a book value basically as we stated before is what the value is for tax purposes. In other words, they bought the equipment for $80,000 a couple of years ago. They've taken depreciation and the ACRS over the last couple of years, and now the equipment's only worth $40,000 from a tax standpoint. That does not mean that this is what the value of the equipment is.

Now, what I'd like you considering doing is one thing. I'd like you to realize that when you go out in the world, there's going to be two extremes that people that are going to give you values on equipment.

Number one, the first on e you're going to run into is going to say, "Hey, I bought it for $80,000. It got depreciated at $40,000. The book value now is $40,000." Say, "Hey, that's great." On the other hand, you're going to find a group of people, and they went down to Charlie's Junk Yard last week. They bought this equipment for $200. They have now marked it up to $40,000. Why? Because everything goes up in value. Neither approach is accurate, and what I'd like you to do is I'd like you to go out to the equipment company that supplies you with replacement equipment in this industry, and they will give you an appraisal on this equipment that you have. What do they charge? Normally nothing. Why? There's no free lunch. They want to sell you more equipment. You're also going to find that they have a book similar to the Blue Book that they have in the automobile industry. It may be chartreuse, green, yellow – who knows, but you're going to find they have a book also that gives the values of the used equipment that's associated with the equipment that they're selling.

So, you're going to find that it's easy and they're not going to charge you for it. So, do find out what the equipment's worth because you're going to find in the past depreciation was a legitimate thing. You'd buy equipment for $80,000, and after a couple of years it wouldn't' be worth more than $40 or $20, but today with the inflation that we've had in the last few years, there's a lot of equipment out there that you're going to run into, and the equipment is worth a lot more than what they paid for it. You're going to find a lot of value in this area. In fact, this is an area that you like to contact me on all the time because you say, "Gosh, I'm buying this business here, and the business – the owner wants $100,000. The equipment's worth $200,000." What I'm telling you is when you run into things like that, what you've gotten is what we call a good deal. So, analyze it, get as much information and possible, and get as accurate appraisals as you can to hard value assets. Don't go out and just wing it because if you wing it you may be making it plus or minus $100,000. That's a lot of money when you're pricing or valuing a business. So, get as close as you can.

The next area we start to get into is a thing called the liabilities because when you're going out to buy a business, you're going to be able to buy it for the assets minus the liabilities. So, you better get the liabilities in there accurately and make sure you're not paying for something that doesn't exist.

As we start to look at this area, the basic one we have is the accounts payable and we've already discussed that, but you could have other things like taxes payable. You could have accrued salaries, and other different items under liabilities. Each one of these things you take on make sure is a real expense, and keep in mind as you do this, if you happen to be the buyer, each one of these items that you do assume do what to the value your paying? Lower it.

Once we've analyzed these, simply take the assets and subtract the liabilities. We end up with a total value of how much? $190,000 which is basically the net worth of the company. This is the net worth of the company, the book value. This is hard value assets that we're talking about right here.

Now, at this point, what I want you to realize is what we have done here is just put a summary of what? The balance sheet. The different hard value assets. Nothing magic about it. I just tried to educate you again a little on the different hard value assets.

Now, we covered Section Three. What I'd like to do now is swing over into Section Four, and talk about the area on the front part of 5-9 that is the most difficult. You're going to have to go through this a number of times. You've going to have work a number of businesses before this is going to start to sink in, but Section Four is what we call the adjustment and the profit for the cost of return of the following items, and what you're going to find is when you get involved in business and you have money invested in cash, this is your money. If you have money invested into accounts receivable, these are dollars that you have put into that company or you have in that company that you could have placed elsewhere.

Quite often, you're going to find as you get involved in a business, as you go on, in the beginning you're not going to have a lot of profit. As you start to generate more and more profit, what the average American businessperson does, because it's the American way, is they plow all the profits back into the business, but the thing that's wrong is – there's nothing wrong with plowing back profits – the thing that's wrong is you don't keep track of what you're company's paying you.

If you'd made a profit last year of $100,000 or pulled out $100,000 cash, and the company then has a need for $100,000 to buy brand new equipment, if you're going to replace that equipment and put that money back in the business, what return are you going to get? I mean, if you can go out to the marketplace and get $10,000 on that money you have or $15-$20,000, why would you lend it to your company.

In fact, right now I want to develop a hard stance which is in analyzing or even running your companies, you don't put the money back into the business unless the company can justify it. If you don't do that when you get involved in business, you're going to find every one of your employees coming to you and saying, "Let's buy this new piece of equipment." Well, if it's replacement, fine, but if you're buying something that's supposed to speed up production or you save time. If it can't justify the cost you have and the return you should be paying yourself on the money that you've invested back in your own company, why are you doing it?

One of the classic examples we run into may help you. Now, this example here, we don't have this. We have real estate, but the real estate's owned by somebody else, and we pay them in rent. We have a lease payment $10,000 a year. But, suppose in this example we did have real estate. We owned the piece of real estate.

Now, which way would you go? Would you leave the real estate in the company and live rent free or would you do the thing that's smart tax wise and also psychologically? And, that is to take the property that you have, the real estate, move it outside the company, and your company make lease payment to your other company. You'll find it not only benefits you tax wise, but you're going to find it benefits you psychologically. Why? Because your company is paying a legitimate rent.

Now, the money you've invested in real estate most of you have been brainwashed to the extent that anytime you invest in real estate and you also have a company, you know that you should pay yourself for rent because if you invested X number of hundred thousand in this piece or real estate, your company should pay your real estate division, you real estate profit center if you want to call it that, a return because one should pay a re turn to the other. Each one should pay it's own way.

Now, most of you are willing to do that, and you say, "Hey I've got a couple hundred thousand invested in real estate, so I should pay myself a return of a blank amount of money." Great, the thing that really gets me is as soon as we take the same amount of money and invest it in some other asset. You don't want to pay yourself. What's so sacred about real estate? What we're talking about, real estate's just a vehicle. I don't care if you invested that $100-$200,000 in real estate or if it's invested in cash or receivables or equipment, whatever it happens to be. You have to pay yourself a return.

As you start to analyze the business, you have to realize if you want to compare a business like this to a service business, the service business would probably have no assets. I mean you have one orange crate, two pencils, all leased. So, you don't own anything. So, what happens is you'd have a service company making $150,000 with no investment in assets. You don't have to replace the assets which means $150,000 you're going to get to keep.

In these other businesses, you're going to have to realize, if you put this money in, you're going to have to pay yourself a return, or if you have to go out to the marketplace to borrow this money, those banks are going to want to charge you interest. I don't care what way you look at it, you have to pay a return.

Now, let's start to struggle through this, and if you have trouble with this I want you to keep in mind, if you were to go out and mail from one of those beautiful packages from one of the larger merger and acquisition companies in the United States on some large company, they would have a section in their package on that business for sale on their evaluation that had to do with Section Four.

In fact, when you look at Section Four which is on something has a big probably four postage stamps, the large merger and acquisition people and the MBAs that work for those companies, you're going to find that they have devoted 45-50 pages to this one little area. So, as you go through it and have trouble with it, remember, the big people do also. That's why they spend 50 pages describing something because if it were that easy they could describe it in one. I'd also like to add that if they understood it, they could describe it in one.

Looking at Section Four now, let's start at the top here on this area, and what we have is equipment. Now, if we look at the equipment that we have in this business, we have $40,000 in equipment. Now, how are we going to figure what kind of return we should pay if we have invested the $40,000 ourselves - we put the $40,000 in the business in the equipment. Now, how much does the company pay us for the $40,000 we invested there?

What you have to do is realize that most companies if you go out to find out what the going rate is, they're going to quote you at prime plus a certain figure. In this example here under equipment, you'll see written there P+3. That means prime plus three. At the time this example was made up, we assumed a prime of ten percent. Do not worry about what the example is showing you here because as soon as you go out into the real world and start to analyze business, what I want you to do is call a lending institution, any lending institution, do it in the city that you happen to be in that day and ask them what the rate would be to borrow money in this area.

Now, you're going to say, "Well, why do we use a bank lending rate?" Well, the thing you have to realize is if you're going to take $40,000 of your money from your bank account and put it in this company, you're going to say, "Well, I'm only getting a certain percentage, under ten percent. I'm getting eight percent. I'm getting five and quarter, five and a half percent. That's the only interest I'm getting so, if I just get that back, that should be good enough." No it isn't because what the lending institutions have done is build in your rate plus also add in what another factor for the risk factor, and what you have to realize is although you might think that you're the best owner in the world and your company is the best in the world, you have to realize that we have to build a risk factor in if we're going to loan money back to this company to figure the return.

Now, on the equipment of $40,000, when we start talking about prime plus three, we've talked to the local organization, and again I want to restate, do not memorize these numbers because in any day in any city, you can call these different lending organizations – banks, savings and loans, whoever happens to be doing the financing – and find out from the what their rate is that day. They'll give it to you verbally over the phone. So, don't memorize this.

In this example here, again, we are assuming a nice even number of ten percent since it is a number that we have not run into very often. Let's say we have ten percent this day, prime, that's what they quoted. You find the bank of lending institution would then quote prime plus three based on the risk factor of this type business which means they would want 13 percent interest. That means that this year that you're going into, it's going to cost you $5,200 because if you find in this business that you have $40,000 of equipment, you've have had to either borrow at 13 percent or put your money in at 13 percent which you'll be doing later as you start to make money. You should subtract from the $150,000 the $5,200 because it's just like paying rent.

If this happened to be rent on this equipment, this is rent that would be going out of the company. It'd be repaying yourself or if you want to consider it another way, the company really isn't making $150,000. It's making $150,000 minus the $5,200 they should be paying interest to somebody, a bank, or the return that they should be paying to you, the owner or the person that invested the money or assets in this business. And, again, you have to develop and understand this philosophy and it's going to take you a while, but once you do you're going to find that you're not only going to do a great job of analyzing businesses pricing wise, you're also going to be a fantastic owner because you're going to understand the basics of what makes a company work. It's not that difficult.

The next thing you have here is the inventory, and if you look over, you'll see the inventory was $50,000. As we call lending institutions, they quoted prime plus two on this which was 12 percent, which means if you take this it's going to cost you $6,000. I mean it's going to cost you $6,000 for just the return on the interest you're going to pay on just this. So, it's $150,000 minus $6,000.

These numbers start to add up. In fact, you're going to find a lot of large companies will show $150-$200,000 net profit and when you subtract the return, they show nothing down below. Are those companies you want to get involved? No way.

Now, you have inventory here and it's costing you $6,000. Do you know the thing that's really fascinating here? You're going to have $50,000 in inventory. Supposing we're going to be able to show you ways to own $50,000 inventory, have it in there – excuse me, I want to stand corrected on saying own – suppose you have the $50,000 inventory in there and suppose the $50,000 is available and suppose you don't own the inventory, suppose somebody else owns the inventory. It's like owning one of these big furniture stores and they say, "We have six million dollars in furniture." You go in there and say, "My gosh, how can you afford so much furniture? How can you carry so much on the books?" They'll laugh at you. They don't own any of it.

Later in this program, we're going to show you how to have as much inventory as all of your competitors and how much are you going to own? None of it or very little of it, and again, as you do this, you're going to find asset by asset although the person that owns the business today has all this invested, by the time we get finished with you on this program, you will find that you don't want own anything in the business you're involved in except what? The cash flow. Let everybody else own the equipment, the cash register. All you want to do is own money, and the people in this world that make the most money are the people who only own the money. You don't want to own these other things.

Next area, the receivables – now when we start to think about the receivables, and we've talked about this before. The receivables amounted to $150,000, and we said we're in he financing for $150,000, but we don't look back later and subtracted out the thing called accounts payable, and what we're saying was we're really not in the financing business with $150,000. We're in the financing business to the difference between the receivables and the payables.

So, it's the accounts receivable of $150,000 and the accounts payable were $100,000, that means we're in the financing business for how much? $50,000, fantastic. So, when we go to the bank or the lending institution, they'll quote prime plus three. You've got 13 percent. Again, this comes to $6,500. Now, remember we're not multiplying by the $150,000 or $100,000. We're multiplying the 13 percent by what? The difference between the receivables and payables, the amount that we're in the financing business for, which comes to what? $6,500.

Now, supposing later as we go through the program, we're able to show you ways to balance out the receivables and payables? Well, if the receivables balance out the payables, do you have to pay out $6,500 next year? No way.

Supposing we get to the point where we show you how to make the payables larger than the receivables – if this number is a minus figure, because you're in the financing business, what happens when we show you how to put the other people in the financing business? It becomes a plus.

I just want to make one comment here. We're now looking at pricing a business, but for those of you interested in buying businesses that are going through this program, I want you to realize that you're going to be able to in the month, two, three months after you take over your business – take a business that you're paying X number of dollars for, and add 20, 30, 40 percent to the value just by the things I'm showing you right here. You don't have to get out of your house. You don't have to get out of your kitchen. You don't have to do anything. You don't have to be creative. You don't have to increase your sales, and you'll find that if you want it to turn around a couple of months after you bought you can then sell your company for 40-50 percent more than you paid for it with only these techniques we're about to talk about here.

The next area is a thing called working capital and although most people worry about working capital and think of it as the most difficult financing to get, it's not true. You're going to find working capital is the easiest financing to get as you'll see later in the program. You're also going to find in most cases, it's the least expensive type of financing.

In this example right here, again we go to a lending institution. They quote us prime plus one, P+1, and again, as in the example, we had assumed ten percent prime rate at that time. You're going to have to go back and adjust it based on what it is today. It comes to 11.

We take the 11 percent times the $50,000 we have involved in cash in this business, and it's going to cost us $5,500. Or, if you've gone to a lending institution, you're interest alone or the return you have to pay is how much? $5,500.

Once we add up all these adjustments or if you had gone to a lending institution and bought this money, this would be your interest deduction. I mean, this is real money. You're going to find $150,000 subtracting the $23,200, gives us an adjusted net profit then of $126,800.

I'm going show you in a minute how to use this, but I want to mention a couple of things. First of all, if you're in this area and you have an adjusted net profit of $126,800, you're fine. But, supposing you have adjusted net profit of zero. Do we go any further? No, because if you have a zero adjusted net profit here, what it really means is if you go over to your right here to total value, this company is worth max the hard value assets of the company because the adjusted net profit comes up to zero, it's not worth anymore than that.

I don't care if they show $100,000 net on their statement or whatever. It's not worth anymore than the hard value assets because the company really isn't making money. They're only kidding themselves.

Now, it could be worse. Supposing the adjusted net profit comes to a zero figure. That means that it's worth $190,000 minus some figure. If they have had an adjusted net profit, if you went back two or three or four years, you may find that they've had such a bad run on the company or they have so much equipment on the company that if you take the adjusted net profit over the last three or four years, you may find that the true value to the right minus the negative figures for the last couple of years will give you a zero number or a minus number. What would that mean? That would mean the seller of the business should give you all the assets as a buyer and then add cash. In other words, they should give you money to take it off your hands. I want you to realize though in the real world they're not going to do that, but what we want you to do especially for a buyer is walk away. If you're a seller, I suggest you work on correcting your problems before you sell them because you have a business that unless you find somebody that doesn't what the heck they're doing, somebody you can rip-off, you're going to find the average knowledgeable buyer is not going to buy this company.

What you do now is move these numbers down below and if you'll take the $126,800 and move it down to Section Five where is says Hamel Business Value equals. If you just go across, you'll see you have $126,800. You're putting that in there.

What I'd like you to do then is going over to the right is take the value that you come up with before from your Balance Sheet of $190,000, and you move that down under what? The total value.

Now, what we have here if you want to look at the statement, it says Hamel Business Value equals total value plus weighted business values times the adjusted net profit. The Hamel business value or the value of the business you're about to come up with in this program is going to be equal to two things.

Number one the $190,000 which happens to be the hard value assets or the assets you can clutch and feel, and these are the assets from the balance sheet. That comes to $190,000. Then, the other half of it that we're about to go into which is to the right of the $190,000 are the things we call the intangibles. What's the value of the intangibles? What's the value of the goodwill? The blue sky?

Whether you call it intangibles, goodwill or blue sky, everything to the right of $190,000 is how we arrive at that, and what you're going to see is we have a value of 3.39, and you say, "Where did that come from/" Don't worry about that. We're going to arrive at that on the backside, as we go in and try to figure out what the value is of what? The value of the goodwill, the value of the blue sky.

Now, what you're looking at here if you want to look at the value of a business, when we analyze the value of a business, the business is worth the hard value assets – in this case $190,000 – and also so many years earnings. And, that's what we're looking at here. We're looking at, we're going to end up with an answer here of 3.39 million year's earnings are adjusted for the return, and that's what it's based on. It's hard value assets plus what's the value of the cash flow, the location, the management and all these other areas.

Now, the thing I want you to realize as you look at this. As you go out and compare what we're doing here with other systems that are used by other people all over the country, whether it's IRS or Bank of America program, the only difference between our program and their program is in certain areas where they basically tend to throw a dart at the board, or use subjective judgment, we have arrived at the figure mathematically, and you're going to find because we have done it mathematically, we are not only more accurate, but we have answers that are more consistent as you'll find out as you use the program.

Now, we now have gotten in this area and what we're going to do now is move one. Now, before we move on, there's one thing I want to mention we'll come back to later. Supposing you're analyzing this business and the profit was $100,000, can you come back later and adjust it later? Yes, we can, and we'll show you how we do it. It's very simple. In fact, you're going to find one of the benefits of working with weighted business values is everytime you want to make a change because the seller or the buyer or something has changed either small or materially, by just changing one thing and multiplying the adjustment times the weighted value and either subtracting or adding to the price, you find out what the new value is, and you're going to find in every case the system is set up so that you can make an adjustment or change in the program in less than a minute. That's how easy it is.

What I'd like now is you're going to be turning to the other side of the sheet and what we're going to be doing is getting involved in a thing called hard value assets. Now, as we continue on now with M Manufacturing, I'd like to restate something we talked about in the other tapes, and I haven't talked about yet on this one.

That is when you're going through this, try to clear your mind of all the other sections. Although we're going through Profit and Loss and Balance Sheet again, the thing I want you to realize – we're going to cover it in enough detail for you. What I'd like you to do as you go through each section, just try to concentrate on the section you're working on and try not to think how it applies to anything else.

Later, as we get through the program, we'll tie everything together for you, but if you want to make your educational experience a lot better and make it a lot easier, just try to take each section, learning that section as you go through it and then later we'll tie everything together for you and make it better.

Now, we're now going to be going as we said into the area that we said has to do with the intangibles, the goodwill, the blue sky, and again, these are all interchangeable terms. They all mean the same thing. What I'd like you to do is start to get your areas set up for the analysis, and I'm going to have you flip over the sheets because we've already gone through the Profit and Loss and Balance Sheet, and I'd like you to take the Profit and Loss which is 5-3 and turn it over. We're looking at 5-4, and you'll be looking at the Business Opportunity Owner Summary Statement. Again, this is a summary of information that we have for you. Then, on M Manufacturing on 5-5, you'll flip that over and you'll find a thing called Business Analysis Sheet.

On both these sheets, we have information that's going to be required for us to be able to go through and analyze this business to find out what the value is, to find the value of the intangibles and the goodwill, blue sky. One thing I want you to keep in mind as you look at these two sheets, and that is that this information is provided by us in this example, and as you go out in the future to value a business, this is information that you're going to have to gather from the seller of the business or if you happen to be the seller of the business, this is the information that you're going to have to put together as you analyze the value of the company.

Now, once you have this and you have turned over page 5-9, you're looking at the backside which is 5-10. It says, Hamel Business Value on the top. You have three sheets in front of you which I think is fine.

Now, what I'd like you to do now is since you're on 5-10, if you look straight across from 5-10 in the book, there is a thing called sheet 5-11. Now, what we have done here on this sheet on 5-11, I have listed the different categories that we're about to go through.

Now, before we go through that, I'd also like you to flip one more page and look at the back of 5-10 and 5-11, just flip over to 5-13, and what it says is pricing a business with Hamel weighted business values. What it's saying here, "its purpose is to establish a first step to set a standard for pricing businesses, and to provide our associates with a tool to help explain to others the details of the value." You have to realize one of the things we haven't even discussed yet is a system like this enables all parties of the transaction to explain not only what the value of the business is but how it's arrived at, and what each one of the segments the value is worth.

Now, caution what we're trying to tell you is no one is authorized to make copies of this program, and this is intended for the use of other Hamel business seminar students or people also buying our tape programs. You're forbidden by law to copy this program for any other person or company. We do check this and we strictly enforce it. Why? We spend thousands of dollars developing it, and we don't mind you using it. We just don't want you using it against us.

Now, this pricing system is set up to be the next step forward from the pricing of business using multipliers based on sales, and multiplies – as we've already said – based on that profit.

Now, you're going to find the staff at our office has been using this system to assist former students of our program since 1978. It was first publicly announced at the Certified Business Counselors meeting in Tampa, Florida in January '79. It's been tested continually and only implemented in May 1980. In other words, we checked this out in thousands of businesses before we actually put it in, and you're going to find as we've gone along, we've checked it out continually since then. Why? To find out flaws and find out different problems.

Incidentally, over the years, the main thing that we really have found that we have made mistakes on have been grammar, punctuation and spelling. I'm sure it will continue on.

Over the past two years, many bugs have been worked out in this new pricing system. Unfortunately, many still remain. We felt with your help and with your suggestions for improvement, we should be able to work out most of the small problems and what we're saying to you as you go through things and you're finding things that maybe have changed that don't fit. If you get back to us at our central office, you will find that we will make the changes and we'll get back with you with the changes.

Warning, this pricing system is not a panacea of the living end of pricing problems. We're not intending to replace the valuable job done by the professional business appraisers. What we're attempting to do is simplify pricing. We're only attempting to set standards of prices for business in the country. Please keep mind these are standards against which each of you can measure a business.

Over the years, as we educate more and more people, we hope to bring more business prices closer to standard as we're hoping to establish, and again, we have corrected a couple of them as I have mentioned.

So, remember use this as one of your tools, but don't get hung up on an exact price, and just use it as a guide. If you find a business that completely falls outside the range of our program, you may have to come back and let us assist you.

Now, what I'd like you to do now is turn back to the pages we were just talking about, and in front of you, you should have pages 5-4, 5-6 and also in your books you should be turning to page 5-10 and 5-11. That's what we're looking at right now.

Now, the back of the pricing sheet that we were talking about prior tape, is on page 5-9. This is the back side and we're going to be covering a thing called the weight business value, the value of the goodwill, the value of the blue sky. We're going to be going through 25 different categories.

Now, years ago when we first set this program up, and I told you we announced this in Florida at one of our national meetings, the thing you have to realize is I had a program and I had 25 categories, and the problem I had was many of the categories had 30, 40, and 50 sub-paragraphs which means it would take you somewhere between one year and two years to price or value a business. Was it accurate? Fantastic.

As a matter of fact, as we analyze this, the thing we realized is we had a program that was very accurate but how do you teach it to somebody? How do you show somebody else how to use it? You have to use computers.

Finally, somebody came to me within a couple of weeks after the meeting that we had back in Florida a number of years ago and said, "Hamel you're a typical engineer. You've over engineered it. Why don't you broaden the parameters? Why don't you lower the number of areas, categories that you have in each one and you'll have a better system?" I said, "Ah, it'll never work. That won't be accurate."

Now, it did sort of spark me, and what I did is I went back and checked, went back and modified it and tried it, and I hate to tell you this, the person who mentioned this to me was correct. As we went back and analyzed it, we found that unless you took the price, the four decimal points, you didn't need the accuracy that I had built-in in the beginning, because unless you wanted to price it to $500,000.43 and so many tenths of a cent in mills, we really didn't need the accuracy.

As we've done this we've found that it is very accurate without having all the categories. I want you to realize that all of the equations we did develop in this area were straight line equations, straight line functions. So, if you want to do a thing and interpolate, which means take a point halfway or a quarterway between the points, feel free to do it.

As we start to go through this area, the other thing we ended up with is at the end, we ended up with 25 basic equations because we were measuring 25 categories as you can see on 5-11. Number one, percent of the business the owner will finance. The answer's straight on that – the payment period.

In fact, the first nine categories as you're going to find out are financing categories. So, once you get through the financing analysis of a business, you're going to find you've taken care of nine of the 25 we're about to go through which is not too bad at all.

Now, as you start to realize we had 25 equations. We sat down, and although the equations were very accurate what we had was equation one said we had four apples. Equation two said we had two tangerines. Equation three said we had four grapefruits. The problem is by the time I had finished all 25, I really didn't have an accurate measurement, and I didn't have apples or oranges. What I had was a fruit salad, which means I really didn't have anything.

So, what we had to do was sit down and use a system or a thing called weighted values, and relate everything back to the same thing so that we could actually add one to two to three. In doing this, you have to realize we had assume zero points. We call them anchor points, but what ever you want to call them, you have to realize one thing. as you go through these and see certain values to be "00" or ".00", it doesn't mean that they are zero, or they're nothings. What it means is they are zero in relation to the total system. So, keep that in mind. It's zero in relation to the total system because we had to assume or start at some point and assume that to be zero.

If you can start with number one right now, what you're going to find is we would like you to go through these and as you look at number one and find out how much owner financing you have, what we'd like you to do is in addition as you look at 5-10 not only circle what the value happens to be – in this case .41 – but, also right information down as to how you arrived at this.

Now, the reason we have this comment area or the information area where we right down how we arrived at this, many times when we're evaluating a business to find out how much it's worth, in fact everytime, you're going to find a lot of these values will change as you go into deeper analysis or people change their mind on different things in the transaction.

You're going to find that the value of the business will change. So, what you have to do is please write down how you arrived at it, and do it in pencil, and that way when you come back later and want to make a change, you can erase it and put in the new information as to how you arrived at it. If you don't write the information on this sheet, and you're working on ten or 15 businesses at one time, you may have to go through a stack of papers two or three feet high to try to figure out how you arrived at that one item of price. So, please, under comment do write down how you arrived at it.

Now, what I'd like you to do now to see how good you are at balancing things. I'd like you to take page 5-4 and 5-6 and move them up in front of you, and what I'd like you to do is I'd like you to pull out 5-10 out of your book.

Now, there's nothing wrong with going back to refer to 5-11 if you'd like. In fact, if you'd like at this time, maybe it would be also good to pull out 5-11. Please then, close your book. If you don't do that, you're going to have so many pages all over the floor, you're not going to get back to where we started.

Now, in front of you now you should have page 5-4, 5-6, 5-10 and 5-11. What I'd like you to do now in your book after you've closed the rings, I'd like you to flip the page and look at 5-15. So, in front of you, you're looking at five different sheets of paper as a guide.

Now, what we're going to be doing now is we're going to be going to the different weight values to arrive at the price of what? Of the intangibles, the goodwill, the blue sky, and what you're going to have to do now is get to these sheets to dig out the information. In the future, you're going to be digging it out by talking to the seller or going through certain documents.

Now, first of all, the financing categories. We have the first nine categories of the 25 are financing categories, and of the nine categories that are financing, we have the three subcategories because there's only three basic financing categories that you're going to run into.

Now, in this program, as you get to the section on financing, you'll find later in the program that we have broken financing into three sections, but we also have a supplemental section. So, let's talk about the three main ones right now.

Number one, the first category is owner financing. In other words, the owner is providing financing. The buyer puts down so much when they buy it, and the owner finances a certain amount of that company.

Our next type of financing is supplier and vendor, and again, these are the people that you are supplying goods to or services or people are supplying to you. These are associates of yours when you're in business – suppliers and vendors – and they provide financing.

The third category is the one called institutional financing. In other words, you're going to an institution. You may be going to a bank or savings and loan or the federal government and the Small Business Administration. This is institutional financing.

Those are the first nine.

Let's start now and start going through this, and again, as you go through the first nine you're going to start to get a feeling as to how this works, and you'll find by the time you get to maybe ten or eleven, you're going to start to get a feel for what we're really doing here, so be patient with yourself.

Number one, what is the percent of the total business that the owner will finance? Because what we're looking for is 100 percent financing, or as much as we can get. So, the first thing is how much will the owner finance? And, you're going to find as you go around the country, this has been the standard for the last few years, most owners want 25 percent down on a business that makes between $50,000 and $500,000, and most owners will then finance the other 75. With the other 75 percent, they'll finance it and they'll let you pay off that 75 percent out of the business. So, what are we concentrating now? We're trying to get that 75 percent financing down pat, and keep in mind one thing – why would financing give a business value?

Well, think about it. Which would you rather buy – a business where the owner wants all cash and you have to go out to a bank and borrow at very high rates, which reduces your cash flow, or an owner where an owner's going to provide you with much better financing, longer term financing, and also in most cases at a lower interest rate?

What does that do? It improves your cash flow, and also you're going to find it will do what? It will increase the value of your business. So, financing is a big part of the value of a business, and you should consider that first because that's the key to success whether you're buying it or selling it.

For those of you analyzing this from a selling standpoint, the more financing you provide, the more money you can get for your business. You're also going to find the better terms that a buyer gets in buying a business, the lower the failure rate because if the seller puts a noose on the neck of the buyer when the buy it and make the financing so tight that they have a noose that's very tight, no light at the end of the tunnel, when something happens, those buyers will walk. They'll walk away.

If you give the buyer breathing room, and even though the noose does tighten once in a while, the average buyer will not walk away. In most cases, we find that the reason the transaction doesn't work and the buyer fails is the buyer didn't have any breathing room. So, give the buyer some breathing room in the transaction. Structure it so makes sense. If it doesn't make sense, move on to something else.

Now, first of all, we're going to be talking about the owner financing, the first category. What is the percent of the total business the owner will finance? And, what I'd like you to do now is turn to page or look at page 5-6 which should be right in front of you, and if you come down on the right hand side of the sheet about eight inches it says, "Owner". It says, "Sell, yes" and it says, "Terms", and it says, "25 percent down, ten years ten percent." You say, "My gosh what does that mean?" Well, this is shorthand that's used in the industry and you're going to have to learn in this program, and you should learn it by the time you finish these tapes.

First of all, what we're saying is the owner wants 25 percent down. That's a standard. You're going to find then that it also said that the owner will finance for ten years at ten percent interest. It's just shorthand. Okay, 25 percent down, ten years, ten percent. Where do you get the rest of the money? We'll get into that later.

Now, the percent of the total business that the owner will finance and if you come down the sheet to percentage where it says 75, 61-80. So, 75 percent financing against the weighted value of how much? .41. What you're going to find when we finish, we have given you the answers mathematically. When you finish all you're going to have to do is add these 25 together, multiply it by a thing called the adjusted net profit, and you have what? The value of the intangibles. You have the value of the goodwill. You didn't have to throw a dart at the wall. You didn't have to do anything magic. You didn't have to guess. You're going to know mathematically what the value of what? The goodwill is, the value of the cash flow.

Now, .41 – so, on line one of 5-10, you would circle .41, and write down the information, order financing – 75 percent, ten years, ten percent. Then we can remember later.

Now, the next thing is number two – what is the interest rate on the owner financing? That's difficult. What's the interest rate? I've already told you, ten percent.

Now, ten percent, which comes to .00, it's one of our anchor points. It doesn't mean it's zero. It means it zero in relation to the total system. So, on line two you circle 00 and again it's the interest rate of what? Ten percent.

A lot of you that have not been involved in business or involved in larger transactions, probably do not realize, and we're going to cover this in detail alter, that in financing a ten percent interest rate on owner financing is very high. In most years, you're going to find that the interest rate on owner financing runs seven or eight percent, and you're going to find even in the last few years when we had very high interest rates and the prime was up very high, most owners were financing at nine or ten percent.

Now, don't come back to me and start talking about the imputed interest rate that IRS has in here because I'm trying to tell you what the real world is of what's happening out there, and if you're talking to a seller and a seller tells you that the going rate is 14 percent or 15 or whatever it happens to be, ask them a question, "Is that the going rate for 20 years on the financing, or ten years" What has the interest rate been over the last ten or 15 or 20 years? And, most sellers will laugh and say, "It's been six, seven, eight."

So, even when you're paying seven or eight percent as a buyer, that's not a bad interest rate over a long period of time. Even though the banks are going to make you think otherwise.

The next thing is the payment period of owner financing, and you're going to see the owner tells us he will finance for ten years which is not a bad start, you're going to find out many owners are going to start out and may want all cash. So, you've got them up to ten years. Again, we don't give you a big star as ten years also because most of the people that go through our program, 80 some percent of them, get 15-20 year financing. Twelve to 14 percent of the graduates of our seminars, get 25-30 year financing. So, I just want to tell you from the Hamel standpoint, if you want to get ten year financing, you don't even get a star. It's not bad, but it's only a beginning.

But, it's not a bad start, because remember, we're analyzing this business, and it's basically we first talk to the seller. So, we have ten year financing. It's a .35. So, we circle .35, and again, put down the appropriate information.

Now, suppose in a little while the owner says to you, "Hey I feel very good about you, buyer, and instead of financing for ten years, I'm going to finance 20." You say, "Hey great. How do we change this?" Very simple, if ten years was .35 and you looked at the sheet, what is the value if the owner gives 20 years? .63.

Why would a business be worth that much more because the owner gives you 20 year financing? Well, I just want to tell you one basic thing. You're going to find if you analyze the payments and the cash flow you have for ten year financing, you're going to have this much. Again, a small amount of cash flow.

When you start to get the seller of a business up to the point where they will finance for 20 years, you're going to find that the cash flow that you have left over becomes almost obscene, truly fantastic. It also makes it a lot easier to make it, and what we have built into here in equation three is two things.

Number one, what would the additional value of the business be if you have 20 year financing versus ten, and the second part of it is, what would the lowering of the failure rate be because wouldn't you like to know mathematically what the failure rate is? And, what we've done is you don't even have to think about it, we've built in for you mathematically, and you're going to find the more breathing room that the person going in or the better financing you have, you're going to find the lower the failure rate is. So, we built in the two things for you mathematically.

You're going to find that after 20 years, it's just sort of a psychological thing. You don't pick up that much getting over 20 year financing. So far what have we gotten in the first three sections? We've analyzed and gotten values for that portion of the financing that has to do with owner financing, and you're going to find the owner will finance 75 percent in most cases. Now, we'll get into the financing later on other problems or aspects.

Now, once you've looked at category one through three, you've analyzed one of the main areas when you're buying or selling a company. As we start to look at four, five and six, and if you just turn the page, you're going to find we're getting into category two, the second category which has to do with supplier and vendor financing – supplier and vendor financing.

Now, when you have supplier and vendor financing, what we basically have is we have the same type thing. We're looking at the amount that they will finance. What is the interest rate? What is the payment period? Now, remember these are people that are supplying us with goods or services, and keep in mind in almost all cases, we are their customers. As we get into financing later, you're going to find that we're talking about borrowing cash from these people. This is not getting extended credit. This is not getting all the other benefits you get from your fellow business owners. This is cash. Cash we're going to be using to buy this business or for working capital, but basically to buy the business.

Now, in this case right here I want you to realize this M Manufacturing Company happens to be a real company. In fact, in all of our programs, there's only one example we've ever used in all the programs we've ever taught that were not businesses we owned or have owned, and if you'll recall the only one that we have in this program is the one that we had in the section on the Profit and Loss, and the reason that we don't use our own, that business as you'll recall is the one that is fraudulent and we don't like to use companies of ours that are violating the tax laws. That would not be very smart.

Okay, now the percent of the total business the supplier will finance. You're going to find in this case, we're able to get the rest of the financing from the supplier and vendor. Now, don't start to muddle your mind right now whether you can get this financing or now. We'll talk about that and hopefully we can convince and show you how to do this later in the program, but right now I just want you to concentrate on the fact that this happens to be a real example, and I can reassure you that we got 25 percent and we borrowed it from the suppliers and vendors. We got 75 percent of the financing from the owner. We borrowed the other 25 percent from the suppliers and vendors.

Now, supposing I had to use my own money. Supposing I went through one, two and three, got owner financing, and on the other 25 percent, I had to use my own. Well, if you do that, you have made because on four, five, six, seven, eight and nine, it's not applicable. You just take four, five, six, seven, eight and nine and don't fill those out. Why? Because the only financing available is what? One, two and three. The same thing happens if you solved your financing problems in six of the nine. You leave the other three blank.

Now, this example here, we've gotten all of our other financing from our suppliers and vendors, and it comes to 25 percent. So, what is the weighted value here? .43 which you enter on your sheet.

Number five, the interest rate on supplier financing – the thing I want you to realize, the average interest rate in the United States when a supplier lends you money is zero. Now, when I tell you zero you have to realize there's no free lunch, but you have to realize that although they may be lending you money today, in the future if you're going to be the owner of the business, somebody's going to come to you and borrow money, and we do a lot of lending back and forth whether it's extended credit, which means letting somebody paying 30, 60, 90 days out or lending them cash. It's done quite often. It's the largest area of financing in the business community. That's where the money really comes from. The thing you have to realize is if we started charging each other interest in business, we'd put each other out of business. We're not bankers. We're just trying to keep each of us alive.

Again, I want to keep myself alive in business, and if you're working with me supplying me with goods or I'm supplying you, I want to keep you alive too. Why? I have an ulterior motive. You keep me good no matter which side you're working on, and if you need money and I have it, I'm' probably going to provide it.

Now, on the percent of total business – we talked about the 25 percent. As we get to the interest rate, in this example here it happens to be zero a .21. Now, the thing you have to realize is there's a little start or asterisk the zero percent interest or the .21, and if you look at the foot note it says, "If zero percent is used, do not use category six, the payment period."

Now, why do we have that here? Because the standard in the United States is and has been, we do not pay interest on this. I want you to be able to go back to this tape program over and over again and everytime you look at number five, Hamel is telling you, "Don't embarrass me by paying interest." Do you hear what I'm saying?

Now, I want you to understand though, if you go out to the community and you find that you run into a supplier, it's you're only source, and the person wants eight or nine percent interest, and the bank is charging 15, pay it. That's fine, but I want you to realize that the standard is zero, but don't blow the whole deal. I mean, just don't' blow it because they're going to charge you interest. Try to talk them out of it. Try to get somebody else to do it, but if push comes to shove and it's a lot less expensive than anything else, do it. Quit thinking about it.

So, what we have here is a weight value of .21, and as I said, anytime you have zero interest, what do we with number six? We eliminate it and we don't use it, and you'll see that number six we just basically crossed through that number.

Now, in this example, we've already gotten the financing that we need. So, if you're looking at seven, eight and nine, you're going to find we're not going to be using it. Let's talk about it anyway because supposing you go through this and you find you do need institutional financing – SBA, bank, whatever – you are going to use seven eight and nine, and they're the same as the other six categories we just went through.

The first one is a percent that the institution will finance, nice and simple. Now, the next one, number eight is not going to be that sample, and although it's not in this example, let me talk to you about it because it's the interest rate on institutional financing.

Now, what we're saying here is on the first 40 percent of business value, if you're buying from the institution and it represents 40 percent of the business value, these are what the numbers are.

Now, when you start to get up to prime plus three and prime plus five, I Hamel, your friend, are telling you everytime – if you get involved in prime plus three and prime plus five loans, I am predicting mathematically or we are, that you are going to go out of business.

Now, on up to 40 percent, you'll see the weighted value is -.50 or -1.0. I want you to realize that mathematically within this, we're pricing the value of the business. I also want to tell you that if in any one category, any one value comes up to -.50 or greater on the minus side, we are telling you and recommending mathematically do not buy that business unless you can correct that problem. Okay, because even though you may have a price on it, what you have here mathematically, what we're telling you mathematically, is you have a flaw in the business, and this flaw is going to sink you.

Again, it could be -.48, anything in the range of -.5, and anything above that, the further above it it goes, the more we're telling you you're going to fail. So, you have prime plus three and prime plus five and I can tell you all sorts of horror stories that happened in the 80s when the prime went up over 20 percent, and that means that you end up paying 25,26, 28 percent interest.

Do you realize on these also, that they want your house as security? They want to cross collateralize which means they want your house and every other item you own? That means they take everything and use it as security. Do you know what these loans are for? These loans are for dummies. These are loans that banks or lending institutions make even though the thing doesn't make sense. In other words you want to buy a business. The business doesn't make sense. If you want to borrow $100,000 and put a million dollars in security, the bank will say fine. They don't give a darn. Why? Because when you fail they end up making even m ore profit. So these are dummy loan. If you want to get a dummy loan get it, but I just want to tell you something. I am predicting not only based on the mathematics but my personal experience, that you're going to fail because what we're seeing is these are normally five year loans and in a five year period, the way the country's running today at least once for a short or long period of time the prime will go up over 20, and when it does, your ship will sink.

Now, that's only part of the bad news. If you go down to section B, when you're going out and getting this institutional financing of prime plus three and prime plus five, on 41 percent or more of the business, how do you like those numbers? -3.7, -3.2, in fact, with just these two numbers on every business almost every business you run into, it will wipe out all the other values that you come up with. Has a great management team – this wipes it all out, and you'll end up with a zero or a negative number. What does that mean? You can't do it. You shouldn't do it.

I want to tell you something, I would say that a thousand percent of the time you're going to fail, but when you get up in this level here, you are up in the major failure area. In other words, your chances of making it is remote, almost none. I can almost say on this one it is none. You're not going to make it, and those of you that don't listen, again, I'm not doing this form a textbook, I'm doing this from experience. I've been in this business over 30 years. I've seen people like you do it wrong. I've done it wrong myself with tears in my eyes. Please no prime plus three, no prime plus five. Figure out someway to do it.

It's not worth failing, and again, if you don't believe it go down to bankruptcy court any time during the week, and you'll see people that didn't listen in these areas. You can't make it the numbers don't work.

The last area, payment period, again, is the same as you had in the other categories.

Now, as we start to go to the next one, number ten, on page 5-18, you're going to start now to get a feel for how this work because this is a little more general in the financing, and what you're going to find as you start to go through the rest of the categories, you're going to find the things that actually make up the value of the business. You're also going to find the things that make a business easier to run, difficult to run, to make it fail, or live that good life. You're going to live in that big boat down in the South Pacific, and it's going to start to boil down to this.

Now, as we start to get into number ten, you're going to find out the next categories, three of these categories ten and a couple of them after that, are actually going to be categories of things that measure value of the business that are actually outside influences. Things that are going to be outside influences that are going to determine how much money you're going to make, how much profit, how many sales, and how easy your life's going to be, and these are good conditions also.

Now, type of market. We talk about the type of market. If you're looking at 5-11 also, it says type of market, where? In the industry – type of market in the industry, and what we're looking for here is we're looking for something pretty good.

Now if you look at your sheet to find out what your company has, you're going to find the type of market within the industry, and it says, 'Type of Industry – Manufacturing', and it says above that on page 5-6 on the left side of the sheet about two inches from the bottom under industry, it says, "Level of market within the industry". So, what we have here is a flat level of a market, and if you want to think of yourself as sort of floating down a business stream. You're in your little business boat, and you're floating down this stream. If you have a flat level market, you're going to find that the stream or the market within the industry is going to have not too much of an influence. You and your management can work a normal number of hours, and your profit and sales will stay sort of flat and level based on that one area.

Now, looking at number ten, you're also going to find that we have an expanding growing market. If you happen to have an expanding growing market, you're going to find that just by going down that nice business stream with your management, and working very few hours, you're going to find the industry or the market is going to do what? It's going to drag you up with it, and you're going to find you and your average management will be able to sit there, work a normal number of hours, and the industry itself will do what? Drag up your sales and drag up your profit. That's a nice business to be in.

The worse category is a thing called declining marketing within industry, and what you're going to find it has a minus number, -.29, and the reason it does is the fact that a business like that when you're floating down that business stream, you're going to find that you have to work 70-80 hours a week to do what? To overcome the declining market, and what you're going to find is those are the businesses that cause you a lot of problems. Why? Because although you're running like crazy, you're running a board with grease on it. What you're going to do is the faster you run the more you slide backwards. So, if you find a declining market within the industry. I'd say beware. In addition to pricing it, be aware of the business you're in.

The age of the industry – the next thing we have here is the age of the industry because basically new industries are get rich quick areas, and very risky. Again, no matter where you go people are trying to get rich quick. Nobody wants to take their time.

As you know in our programs our motto, and the way we operate is, become wealthy slowly. As we try to convince all of you over and over again is you can make more money in business honestly than you can dishonestly, and also if you take your time and dot the “I’s” and cross the “T’s” you don’t have to experience failure. What’ll happen is you’ll succeed everytime.

Now, we start to think about these industries, what kind of industry do we have here. Number one, we have an industry that’s manufacturing, and again what’s the age of the industry? It’s over 20 years, and as you look at this, the age of industry, it’s an old industry established over five. So, this industry qualifies as +.27 which I think is really fantastic, and what happens is the industry has settled down. Although we find in the United States that the failure rate in start-up business is very high, and maybe the overall chance of making it over a four or five year period is only one in ten, the thing you have to realize when you also additionally get into a new industry, you’re going to find that number one your average chance of making it is one in ten, and a lot of new industries, your chance of making it in that industry is one in 400 and one in 500.

So, if you take the one in ten and multiply it by the one in 500, your chance of making it – well, you have more chance of flying to the moon this afternoon. So, what I’m saying is beware of the new industries. Let them settle down. This Horatio Alder stories about the first one in the area, the one that’s going to get rich – no. Just like franchising. What I want you to do is be the first one to go into that business after somebody else does it successfully. Let the other people screw up. And, after they’ve screwed it and gone down the tubes, then you go in and do it.

New industries – we’re talking about in the formative stage – in the first two years. Again, just don’t hold that to two years because you have industries that still haven’t make it. Solar has been around longer than two years and we still have a high failure rate. It’s still in the new area. Why? The state of the art of the equipment is really not very good, and it’s still in a new area. So, you have to look at this and use your common sense. In other words, forget about the two years. It’s still new because some things are going to be new ten years from now.

Another industry that’s been around a while or a business – video discs. If you don’t believe video discs have been a problem, why don’t you contact RCA, and you’re going to find that they’ve had trouble. The video disc business really hasn’t done very well. Again, video tape is taking off like crazy. Video discs, you have a basic problem – number one, you don’t have a lot of inventory. Number two, you have incompatible systems, and you also have a company that has a tape they’re working on right now – in fact, they have it out on the market – that actually is erasable, erasable disc. So, what you’re going to find is the state of the art – stay away from those.

What I want you to do is go out and get involved in businesses that are middle of the road, that are doing very well know. Look at those nice businesses that are start-up – buy one now and then four or five years from now, go out the ones that have settled down. How do you find out? Right now there will be 500 in your area in that business. Get a list of all of them. Five years from now, call them, all of them will have disconnected phone except three or four. When they answer and say, “Hi, there. This is ABC Solar.” Say, “Hi, would you like to sell?” What you’ll find is a certain percentage of them 20-25 percent of them will want to sell, and what you’re doing then is you’re buying into something after the risk is gone.

I keep telling you, if you want to do something risky, go skydiving, buy a racing car, but in business, stay away from the risky areas. Always protect your cash flow. It makes like a lot better. So, what do we have here? We have an old industry established over five years.

The next thing we have and we're going to discuss number 12, is the competition in the industry because what you're going to find is although a lot of you – I'm going to think of you as macho or you're going to be called machoist, a woman, I have no idea – the competition, and what we're trying to do is get you involved in businesses that don't have the competition.

Now, what I'd like you to do is look at the sheet you have here, and look for the area called competition, and under industries it says competition in the industry, it says none. Now, as you go through this I'm now going to start to show little things that are different from what we have on the form here, and what happens is I wrote down what the owner told me in the beginning. The owner of the manufacturing company said I had no competition, nothing, none. So, what you do is race back and say, "No competition." Ah, they were using the wrong terminology, and let me give you the basic thing you're going to run into that's going to give you a little difficulty, and that is the psychology or make-up of different business owners.

When you get involved in a manufacturing company, you're going to find the man or woman that owns that company is going to be sort of laid back compared to the other extreme like retail, and when you go into work for the people that are in manufacturing, they're going to say, "Hey, no competition." That doesn't mean they have no competition. That means that they are laid back people, and competition is a normal part of the business. The only time that you truly have no competition from a measurement standpoint which is what we have in number 12 is when they have a lock on the market, a definite lock. So, don't be followed by the terminology they're using especially with manufacturing.

What you're going to find in this example, although they say no, you're going to find it's really average competition. It's your average business which really doesn't have much competition, but it doesn't have a lock on the market. It's +.09.

I also want you to realize going in the other extreme, we have a thing called highly competitive, very cut throat, clothing manufacturing, a -.93. You're going to say, "Why would I want to go into that?" Well, unless you've been in clothing manufacturing, and you have been successful, I want to tell you something. You shouldn't consider it. Even if you have been in it before, I'd suggest you try something else because you can make more money and you can do it consistently and have a nicer life.

Now, when you get involved in the area of highly competitive, you're going to say, "This has to be retail clothing." No, it doesn't, but when you do go out to talk to an owner of a retail clothing business, and I'm only comparing types of people, you're going to find that compared to the average person who owns a manufacturing company, they are not laid back. The average retail person, especially in clothing, is hyper. You're going to find they'll say, "Oh, gosh, I've got lots and lots of competition driving me nuts." When you go out and check you're going to find they're in the same position. They have average competition.

Now, the reason a lot of you are fooled is the fact that you'll go to a regional mall, and you'll see 28 women's clothing stores, and the owner will say he's got so much competition it's driving him nuts, and you'll believe him. What you don't realize is the average mall has 26 women's clothing stores. They may have 28 when they start, but after a year or two, two weak ones will fall out, and you'll have 26, and that becomes what? Average competition. You say, "Well, there's a lot of them." Let me tell you – the malls have the same thing we used to have years ago in the downtown areas. Women liked to go to clothing stores, 25 or 26 of them, and not spend any money - the same thing with shoe stores.

Now, when we talk about medium competition, we're also talking about something you can come up with which is restaurants. You all think that restaurants is a lot of competition. It really isn't so, and you're going to find that the only time you have above average competition in the restaurant business is when they put too many in an area, and the reason you have this quite often in the restaurant area where there had been an overbuilding is because everyone thinks they can run a restaurant and that's not true.

One last thing I want to mention on this highly competitive, and I'm talking about very cut throat. When I'm talking about clothing manufacturing, I'm talking about clothing manufacturing that changes its styles four times a year. It has to go from design to financing, to manufacturer, to shipping, to selling in a three month period. How would you like to be in an automobile assembly plant and have to change your model design four times a year and also finance it four times a year? And, that's where the difficulty is that we have right here. What you have to realize is, my example is if you're in the clothing business, fine, but if you're not in the clothing business the thing I want you to realize is you don't want to have a business next to the clothing business. Why? They probably have one of the highest burn rates in the country. If it's a good year, fine. If it's a bad year, you're going to find they have a lot of fires. My rule is unless we have a 20 hour firewall, I don't want to be next to one.

Again, for those of you that want to live in Beverly Hills and live in a big mansion, you'll be able to do it in that type business, but also you're going to find that's one year. The next year you're going to be pumping gas like a Hollywood rock star in downtown Hollywood.

So, what I'm trying to tell you is why not stay in the areas where you have steady growth? Go after the ones that you don't have that competition. Why make life tougher than it already is? Go after average competition.

One of the other areas, we talked already about three basic areas that are outside the business that influence your way to make a profit, the ease of making a profit in sales. One of them had to do with number ten which is the market and industry.

The next one is the local economy, and what we have here local economy is another outside influence, and as you're floating down your business stream, you have to realize that what we're looking for is the best which would be a dynamic local economy. If you happen to look at your sheet on again 5-6 on the left side up about three inches, it says, "Economy." Again, it's going to be owner feeling in the beginning. Later, as you start to check it out, you're going to be able to find it out on your own because let's face it a lot of times owners are going to embellish. You can call it lying. What they're doing is they're basically doing some creative selling, and as you start to check it out you may find that it's not that accurate.

So, under the economy, you're going to find local. It's strong, very good. So, what we have here is a dynamic local economy, and as you and your average manager are floating down this business stream, you're going to find that the local economy being very strong and dynamic is going to do what? It's going to have a tendency without you working a lot of hours and killing yourself and putting out a lot of effort, it's going to pick up your sales, pick up the profit and increase it.

Now, on the other hand, if you happen to have a stable local economy, you're going to find the things have leveled off, and we have a value point of .00, but the main thing is you're going to work the normal of hours and the profit and sales really aren't going to do much. You have to be weary of that. When the inflation rate is very low, it's not a problem, but you're going to find if the inflation rate gets higher again – it gets up to five or ten percent again – you're going to have to realize that this business, if you have inflation and have you a stable local economy, you may have to work more hours to do what? Not to overcome the economy, but to overcome the affects of inflation.

The worse condition would be a declining local economy, and that's when the economy is turning down as it has for some time, the downtown area, and what happens is you and your average manager floating down this income stream are going to find that the businesses are going to slide unless you work a lot of hours. So, you work 50 or 60 hours and you're going to find that you're basically level. You find if you work 80 or 90 hours, you may be able to even increase it. But, the thing is you're going to find it makes it very difficult.

Now, the thing I want you to realize is be careful in this area. If you're talking about the economy, and you're in manufacturing in Southern Florida, and you're selling to northern Maine or northern Washington, I want you to realize you have to analyze which market? The market you're selling to because that's the economy no matter where you happen to be located.

I also want you to realize because a lot of you make mistakes in this area that if you're in a city or in a county, and say the county has a reputation like Orange County, California for fantastic growth, but you may be in a retail business in a downtown decaying area, you have to measure the area you're in and the area you're serving. In other words, use your common sense.

In the next section, another outside influence of the three is the nation economy, and the national economy does influence your ability to generate the maximum profit. It's basically psychological. If you remember back to early 1980, we were having runaway inflation. We also had people spending too much, and the government tried to cut this back under the Carter Administration, and what the government ended up doing is actually putting limits on the amount you could borrow. The cut back limits on the credit cards trying to cut down on this wild spending that we were doing in this country. And what happened is as soon as the media starting telling it, it was media induced. The media came back and told us that things were not going well and we were coming into a recession, and within a few months we started to believe that.

Incidentally, the thing you have to realize when you're in business, you have to beware of reading of the business page when they start to tell you this because psychologically, you'll start to back off. I find in business myself, as soon as I have a recession, I don't read the paper anymore, or that section. I read the comic page which is probably the business page also.

But, the thing is what we do in this area then is we go ahead because you're going to find the easiest time to expand is normally during a recession. Why? Because everybody else psychologically and directly have backed off.

Now, right now we needed a point in time because this happens to be an example that we had to fill out. We had to assume a level at the level this was made, we had a level economy which gave us a .00. If you happen to be at a time right now when you're listening to this tape and you're in a recession, you're going to have to use the recession number, and hopefully you're going to be in a period which our country enjoys most of the time which is a growing economy which is .12, but, at this time in this example using .00.

It doesn't have a lot of influence, but it does have an influence to the extent that is media induced and the public is told that things aren't good and they don't buy. Again, when the media then starts to come back and the government tells us things are good again, you're going to find that your business is going to do a lot better generally.

The next category- and one a lot of people don't think about is one that drives a lot of people crazy and it's turnover employees because generally the greater the turnover the business, the more difficult it is to train, retrain and to effectively manage their employees, and what we have in this example right here if you want to find out what the turnover is, if you just again go to 5-6 left-side up about five or six inches. Under employees, it says Turnover-once a year. What it means is looking at our sheet on 5-20, the average employee is on board how many years? One to three years, it's a point .00. That's not bad.

Here's an example here – Hamel's T-Shirts. You come into Hamel's T-Shirts and you're going to find we have a heck of a lot of turnover. In fact, we'll open at nine o'clock in the mall in the morning, we'll close five or six o'clock at night. I have so much turnover that when I open at nine o'clock in the morning, I will go into the business T-Shirts at ten o'clock with a handful of bills, talk to the employees and ask them, "Okay, you've all worked one hour. Who wants to work another hour and who wants to paid off and quit?" And, you'll find that every hour I'm hiring new people. In fact, our turnover is so bad in our T-Shirt shops, that by the time I hit five or six o'clock, if somebody has worked all day for that day I will give them a gold watch and we have a retirement dinner.

There's certain businesses that look for turnover, and you're going to find that a lot of the fast food chains will do this. In the large fast food chains especially in hamburgers actually hire people at minimum wage or a little above, and they will have benefit programs set-up, vacations, bonuses, raises, promotions that come up in about six months. You will find that they will have turnovers of 200-400 percent, and they enforce this because they have found it is easier to bring in new people and train them then to give you the bonuses and the benefits and the promotions and the vacations that you should have coming.

So, what they do is you start to hit your fifth month or fifth and a half month, if you're not a person moving up to assistant manager or one of the people they want to keep, what they're going to do is quit scheduling hours or only schedule an hour a week to force you to quit or they'll end up firing you.

So, they're looking for turnover in a lot of those businesses. That's how they keep their labor down.

The local labor market – this could affect your labor costs and ability to hire and keep employees. Now, the thing you want to keep in mind here is what kind of labor market do we have right here? And, the local labor market here says, "Good supply of help." And, what it means is looking at number 16, you have a good supply of help, it means what? Little competition for employees, so, it's a .00.

Now, the thing you have to worry about is a thing called strong competition because if you have strong competition for employees, you're going to find it's hard to keep people. You have to pay them more which takes away from the value of the business. It also gives you one more problem, and if you've been in business before you're going to find that one of the biggest problems you have and the number one problem are the employees because the people. Those are the things that really drive you crazy as the owner of a business or as a manager.

Now, the thing I want you to realize also in strong competition – supposing you happen to have a retail store and you're in a mall area. You're going to say, "Well gosh, we're paying them minimum wage and there's 18 percent unemployed. You're going to say, "There has to be a lot of people available." That's not going to be necessarily true because you're going to find a lot of times when you're in an area although there's a lot of unemployed, the average regional mall is in a middle class or upper middle class area, and these people do not like to work for minimum wage. What you're going to find is the average mall will need one, two, three thousand people to work there, and you're going to find that you end up going five or ten miles away to get people to come to work there.

If you have a mall location, I would advise you don't pay the minimum wage. You find out what the average wage is on the mall and you pay ten or 15 percent more. If you don't do that, your employees will go out on break at ten o'clock and not come back. You then have to go out at ten thirty, and look for other employees strolling around the mall that you can hire. So, what I'm saying is pay a little more and cut down your overhead, cut down your turnover.

The next thing labor union – do we have a union here? Yes, we do. We have the Teamsters, and you're going to find the Teamsters – the competitors also have Teamsters which is okay.

Now, let me start to go through this now and see if I can do this properly. So, this is the only consideration that the company being considered has a union. Now, if you have the Teamsters, I think you're going to have to agree that their strong, but the competitors belong so it's a -.45. It's not exactly .50, but I'll tell you something. My belief is that you should have a business that gives you as few problems as possible. As soon as you start to have a union, although unions are something that's required in this country, I believe, you're going to have to realize that as soon as you have a union they take away a lot of the rights that you have for hiring, firing and running your company. You're going to find it's almost like working for somebody else.

You're also going to find unless you're the owner on premises running it all the time, the union people are going to do a better job of getting additional benefits than your management is going to do building up the company, and you're going to find the union employee costs as a percentage of total sales – the percentage will go up every year. You'll find that unless you increase your profits and do a good job, you're going to find that that extra money that they're getting is going to come out of your bottom line net, and eventually you're going to be running that company just to employ your people.

Now, as you know, the union thing goes back and forth. The pendulum swings back and forth. All I want to tell you is one thing – if you can find a business without a union, fine. That's one of the nicest things to own as you own your own company. But, if you're in an area where you have unions, then learn to live with it because as long as you have other people that also have unions that have to pay the same rate and have the same problems, then you can compete because you're in the same marketplace. You're in the same problem area. You can then compete effectively.

What you have to worry about is when you do have a union and your competitors don't, and I can tell you flat out your chance of making it, again, becomes little, remote and almost none. That's why we give you a -1.31. Again, a lot of you can argue it. Again, I'm not trying to put down unions. I'm just trying to tell you. You're going to have problems and you're going to have problems that take away from the value of that business, and if I had a choice, what I'd do is I'd try to stay away from unions. I'm too old now to have to sit down and fight the unions.

What I do want you to realize when you talk about the Teamsters, I was a member of the Teamsters years ago. I've been a member of many unions. When unions come to me and ask me why I seem to have an attitude that's anti-union, number one part of it is I represent management, and the other part of it is and I've mentioned this many times, my first union negotiation the windows were knocked out of my little Chevy after I got out of school. I was negotiating with little steel, and when I drove back to my little apartment at that time, many years ago, sitting on that broken glass with the wind and snow blowing into my face, I developed my union attitude that I have to this day.

The other union negotiation I got involved in, they tore the top off my convertible. So, I've had trouble with the unions. Again, I'd like to say something. My best friends are union members, but again all it is a thing – we have unions and we have management. As you're going to find as you go through this program or get to know me or us, that we believe in treating the employees fairly. I don't care whether they're union or not union. We, in this country have to get back to the point where we do a better job with the employees and make them part of the team.

Number of employees, number 18 – a large number of employees in relation to the net profit, the less valuable the business. More employees mean more problems usually in direct proportion to the number. That's stupid. If you think that's stupid, this next sentence is so dumb. How dumb is it? It is so dumb that when we put this in the beginning, we were hysterical with laughter. But, so many people complained about us taking it out, that we have put it back in. What the next sentence says is if you don't want to have many employee problems, don't buy a business with many employees. Can you imagine spending this much money for a tape program and having me say something as dumb as that? But, that's what it is. If you don't want have any employee problems, don't buy a business with a lot of employees because I want to tell you something, the more employees takes away from the value.

My ideal company, I've told my wife this many times, is a company run by robots. Everytime I tell my wife this, she says, "Hamel, if you ever get one, they probably will attack you."

In this business here, the number of employees we have is not unbearable. We have 15 which gives us +.07, but you're going to find the larger number of employees the more problems you have. As a matter of fact, before we discuss restaurants, one of the biggest problems with restaurants is not competition. It isn't because it's that difficult. The main problem you have is for the amount of profit you make in a business like a restaurant, you have many more people than you have in a lot of other business. I mean, there are many restaurants that make $50,000 net a year, and they have 50-80 employees. You'll find many businesses out there that make $50,000 that only have two. Which do I like? Two or none.

The next one type of management – we're talking about a basic problem that a lot of people overlook when they're getting involved in either selling or buying a business. As a matter of fact, most sellers lose sight of this and then they wonder why they end up taking back their business. One of the reasons they end up taking back the business from the buyer is the fact that they didn't set up the financing up right and they strangle the buyer.

The next big thing that we run into is the management problem that the seller leaves the buyer with which they can not solve. Let's go through this right now because let's look at the management of M Manufacturing.

First of all, right here – management available, again going to 5-6 left side up about four or five inches. It says, "Management available." It says there's a manager. The manager will stay and the manager's been on the job for seven years. So, let's analyze that. It says, "Managed by the manager", and going to 5-22 on our pricing, it says, "The owner supervises the manager, and the manager's been there over three." Which is our example here, it's a +.41. Even if the manager under three years because you have a manager is a +.27.

A lot of you listening to this tape right now that have not been involved in business, I'm sure no w are worried about the fact that when you go in to take over a company, you're not going to have any manager. The manager's going to leave. I just want to tell you something. While you're listening to the tape, think about that fantasy because you're going to find out in the real world it doesn't happen very often. Small companies have as good management or better management than large companies have. Small companies have the best turnover than large companies in management. And, most small companies pay their management more than large companies.

You're going to find in almost all areas what is real is the opposite of what you've read because it's the propaganda of the big companies put out, and you're going to find that small companies have better management, great people.

Now, supposing we get to the point where we have one owner, the manager, and he or she is leaving. It has value of only -.03. You say, "Well, that's not too bad." You have to realize when you only have one owner leaving or one manager leaving, you have one manager to replace, and you're going to replace that person. What is the chance of you doing it yourself or replacing that manager or owner with one person, statistically? One chance in what? Yeah, make up whatever number you want. That's not too bad. You can do that effectively – replace one manager, an owner, get a manager, do it yourself. You're going to find you're going to do well.

Where the problems come in and where the numbers become very negative if you look at your sheet, we have two owners and managers that are leaving, or two of your managers are leaving –whatever it is, one owner and one manager. What it is you have two people that are directly in management working full time and both leaving. I just want to say one thing, as soon as you start to get up to this level, you have a -.52 which is what we're telling you as soon as you go beyond one and you go up to two, your chance of making it is little and remote.

If you make the dumb mistake of buying a company or getting involved with a company where there's three people leaving in a smaller company, your chance of making becomes none. In fact, statistically, the failure rate approaches a start-up business somewhere between two people and three people leaving which means you've gained nothing. In fact, one of the biggest things you're buying when you buy a company – it isn't the cash flow – it's the continuity, and you're not going to have continuity of profit without the management people. You have to have them there. And what happens statistically, the chances of replacing one is one divided by so and so. Two is one divided by so and so times one over so and so. And, you're going to find that thing called the denominator, the thing below the line gets very large with two, and if you want to see a large number below the line get up to the three. In fact, in most cases when you get up to three, your chance of doing it is either one in 100,000 or one in a million. Think about that.

What I'm saying is if you're the seller, I would suggest that if you and your two partners have been running this company and there's not other management, that what you do is you start to phase out your different people. Start to bring in one or two managers. Work out a program over a year or two to build in management, and then sell it to a buyer, or stay long enough to crutch that buyer until you can be replaced. If you don't do that the seller loses because you the seller end up having to take the business back and losing your investment, in taking it back, probably down the tubes. You the buyer also end up losing also because you end up goofing up the company because you couldn't take care of that management problem, and you end up blaming yourself, and usually the financing and the management condition is something that is there when there's a change of management, a change of ownership and what you have to do is make sure it's as close to being what you want as possible. So, beware of too much of change of management because that's one of the key things you're buying in a company – cash flow and the thing that generates that cash flow is that management team you have.

The next category is ease of management, and we want to say there's a range of difficulty of management based on the amount of sales generated by direct effort of people. Since people are inconsistent or difficult to manage, and so people in intensive industries such as service are more difficult to manage. In an equipment intensive business, with fewer people it will be easier, and that's what we have in manufacturing, +.26. I'm sure those of you that own manufacturing companies think that your company is the toughest category to run. You just have never owned a service company because you're going to find that basically in a service company, you are earning all of your sales and profit by the direct effort of people. People are very inconsistent.

As you get into retail, you have inconsistent people and a semi-consistent product. It makes it a little easier. When you get to manufacturing, you have machines manufacturing even though people are running the machines, there's fewer people involved. You're going to find the management is a lot easier.

Again, it's not than any of it's easy. It's only easier comparing one to the other. That's all. So, we have manufacturing +.26.

Now, the years in operation – the national figures tell us the longer a business lasts, the better chance that it has for success, and what we have right here is – if you go back again to 5-6 – we want to find out how long this business has been around, not the industry we've already measured that, how long has the business been here. Twenty-two years, if you'll take 5-6 and go up to the left side of the sheet and go down about three inches, it says, "Years present owner – 10 years. Years established – 22." So, years in operation, over 20 years. You're going to say, "Well, gosh it's obviously has more than one owner." Let me tell you something, the longer the business has been around up to a point, the lower the failure rate, and the more owners because if this business has shown consistent growth through three or four owners over a 20 some year period that means that it's almost indestructible. In other words, no matter how bad the buyer is, you're probably going to have a hard time trying to destroy the business – not that they would. It's just that we're looking for the strongest transaction possible. We're looking for the best buyer and seller combination possible.

In this case, since we're talking about pricing a business, I want you to realize we're talking about the things that make up the value. We're looking for strength there. Looking for the good things.

The thing I also want to warn you on as you start to get down below five years, you're getting into the danger area. My rule has always been if it has been down around five years I won't even look at it because if it's been around under two years or under a year, why are they selling? Why would they be moving that business out again? How much value does that business really have? It's been around X number of months, and even though it's showing $100,000 for it's first year, is that going to be a good pattern? Are you buying it based on – I'd rather see a track record of at least five years. So, you're going to find that I like over five years. Why? The failure rate starts to go down quite fast as soon as you get up to the five year period, over five.

Now, the net profit, number 22 – this takes into account the fact that the higher your net profit, the further you are above the break even point. It's a proven fact that the higher profit businesses have a lower failure rate. Now, I want you to realize is yes, we could've built in a break even point analysis to price the business. The problem is instead of taking you nine or ten minutes to price a business, you would have found that it would've ended up taking you every time a half an hour, an hour longer, and we don't want that because you're trying to come up with a simple system that is also accurate.

When you start to get involved in this thing called net profit, we're really talking about a simplified approach we've taken. I also want you to realize since we have broad parameters here, I already mentioned in the beginning that these are straight line equations. Those of you engineering types or MBA types that like to analyze the math, if you wan to take a point half way between or a quarter way between each value, feel free. It will still be accurate mathematically.

Now, in this case here what we're talking about is basically if you want to analyze it from an example, it's a ship riding in water. The ship is riding at different levels above the water line, and you're going to find the lower your ship rides in the water and the closer to the water line is to the side of your ship, the more waves are going to break over the side. The easier it is to swamp or sink your ship.

If you have a business that's making $20 or $30,000 a year, the weighted value's very small because you're going to find even though you're making a profit, you're going to find as you have different problems in the economy, or your business, or your category industry – again, you don't have them just every few years when you have a recession or every X number of years when we have a depression. You're going to find in business you'll have problems everyday, every hour, every minute, and what you have to do – the more money you have, the more storms you can weather – psychologically and also dollar wise.

As soon as you start to get up over $50,000 you're getting into a very good area, and you start to get into a safer area because very few waves break over the sides of those ships. Even when we have our major recessions, you're going to find the largest increase in the failure rate is in start-up businesses and the Mom and Pops. Why? Because they can not adjust to the inflation or the other problems that they're having during these recessionary periods. What happens is the larger companies are increasing their prices to keep up with inflation or keep ahead. The smaller companies, the break even companies, the Mom and Pops and start-ups have a tendency not to do this, and what happens is they sink further behind, and we have a higher failure rate. Also, these companies don't have the money to weather these storms which the larger ones do, about $50,000.

This business right here, we have a business that shows a profit. Again, what you're going to have to do is you have 5-10 in front of you – turn it over because on the front of 5-10 which is 5-9, we have a net profit. Now, what profit do we use in looking at this? We use the real net profit of $150,000 which gives us a value of what? .44. Do not use the value on number four because if you use the adjusted net profit in this area, you're going to be taking into consideration the return that you built in on your different investments. So, you have to take the real net profit or the money before you backed out the return or the interest rate, whatever you want to call it. So, use the pure number of $150 or you'll end up having done the analysis twice, and you'll goof up your analysis.

Okay, number 23 experience skills required – we're talking about another thing that a lot of people tend to overlook when they're analyzing a business either to buy it or sell it. We're talking about the experience skills required to run this business. If you happen to be the person buying this business, you usually either have the skills or if you're going to build in management, you don't have to have these skills because you're going to end up doing what? You're going to manage the manager who has these skills. Just keep in mind though that the more skill required, the lower value the company has because the more complicated it is the higher the failure rate. The more complicated it is the more difficult it is to higher people to run these companies or to administer these companies.

Now, first of all in this business right here, since we happen to have very few employees and a manufacturing company like 15. You're going to find that you don't have the specific people to do a lot of the functions and the owner or the manager of this company is going to have to have these skills – engineering, bidding, blueprint reading, whatever it happens to be. They're going to have to have these skills.

So, we have some experience required of the owner. This is knowledge that you're going to pick up as you go on and become more knowledgeable at looking at business. So, this is -.09. It's not material, but it's something you should consider. As you then start to get involved in manufacturing companies that have more people and have specific engineers to do different jobs, and you don't require a specific skill other than the management skill of running the company, you're going to find that little or no experience is required by the buyer and or the manager whoever happens to be running the company. Why? You could be easily trained, or if the business is large enough to include experts in all the areas.

Now, keep in mind, the little or no experience area is the one we're talking about the owner or the manager wears loafers. In other words, they can't tie their own shoes. They wear loafers. They bang their head a lot. These are people that require little or no experience.

The other thing if you want to analyze this area and figure out what applies here – these are companies that tend to become franchises because if you're going to franchise something and sell it to people that don't have knowledge in that area, you're looking for something that requires little or no experience. It's sort of idiot proof, loafer type businesses. You don't have to have much knowledge.

A lot of retail stores, as you're going to find in malls, they make $100,000-$200,000 a year profit, and they're run by teenyboppers or they're run by young kids that don't know from A to B. But even though these people are young, you're going to find they do a very good job and these companies do very well.

The other area we talk about is the extensive skills, and we have extensive industry skills required by the owner that means it's very technical. It means that you have to hire a German rocket scientist or it means you have to have a restaurant and you have to have one expert chef. There's nothing wrong with having an expert chef or an expert German rocket scientist. It's just that it makes the business more complicated. It also means that you have another key man in there. In other words, I like to have five chefs, or I like to have my chefs 14 years old. What I'm talking about is I don't want to have a person that's in a key position that's working for me that I have to cowtail to because if that person leaves, I'm out of business or the business isn't going to run very well. So, I like to have ones that have two or three, or I have to have or the person running it would have to have the skill in addition. So, try to stay away from the ones that where we have extensive skills required.

Number 24 – the owner's support after the sales – one of the things that a lot of people worry about and by people I'm talking about buyers, very seldom do sellers worry about it as much as the buyer, and again, the buyer's always worried because the buyer's worried that unless the seller stays for five years, the chances of making it is very small and you're going to find the old saying goes, "Yesterday I couldn't spell Owner, today I are one." What that basically means is the buyer's very nervous going in. Within a week or two after they're in there, they understand the business and they really don't like to have this owner around.

So, what we find is the amount of time and effort that the seller will give the buyer after the sale influences the ability of the buyer to succeed. The more support up to a point, the more chance of success.

So, what we try to do in a lot of these transactions is we have the seller stay around full-time for X number of weeks, up to 40 hours, and then we have the owner stay around up to 30 hours a week, then up to 20 hours a week. We eventually phase them out so that we don't end up with these conflicts between the former owner and the new owner.

In this example here, the owner's willing to stay for a period of time, three months which is over four weeks. So, it's a +.21. Again, that's a good example. We're trying to get them to stay. I know a lot of you are not experienced in business think that you'd like to have the owner stay for a longer period of time. I want you to realize that it doesn't happen very often. It's just because the buyer has hang-ups or the buyer has fear, and usually you're going to find as the average buyer that all you're asking the seller about is where's the light switch? But, don't worry about it. Do not fear in asking the seller to stay.

Why would the seller stay? There's no free lunch. In most cases since the seller is carrying back financing, the seller really doesn't like to leave until they know the buyer can make those payments – no free lunch.

The last one we have here is location. One of the most important assets in the business is location. On this one we have three different levels, and if you're looking at 5-6 in the upper right hand corner, it says "Location class – one, two, three", and Location class three, and it's a rundown industrial park. You say, "Hey, that's terrible. It's crummy." Well, the thing is even though you analyze it and find a location, it's not the best location, and when you come over to pricing, I want you to realize that it's still a level two. It's the average location. It doesn't add to your profit, and it doesn't take away. Why? If you go down to the footnote it said, "Please remember, use level two for businesses in which the location is not important to business such as distributorship, manufacturing."

Now, location maybe important in manufacturing from the standpoint you want to have railroad sidings. You want to have trucks, things like that, but generally you don't have to have a beautiful area. You don't really have to care where you're located because what you're going to find is the average consumer is not coming by your manufacturing plant. It's not like retail. You don't have to have the perfect location. So, don't worry about it. You can go level two.

Now, there are exceptions. You may find in specialty industries like the electronics industry or where you have shortage of labor and the employees insist on having four swimming pools, six hot meals at lunch and all these other benefits that you may find that the location is important. But, generally in manufacturing this is not the case. You can have an ugly building and have a beautiful profit because that's what you're after.

What we do now that we've gone through the 25 is we're going to do a thing that's probably the most difficult because we're going to add these up. Now, you might do this as an example because we have left the plus and minus on page 5-10 blank.

Now, we've circled all these coming up and down. What you have to do now is take all the pluses and add them up. Put the pluses on that little line. We've left that blank for you. What you do then is add up all the minuses and put them on that line. Then subtract the minuses from the pluses. If you get 3.39, we'll give you an "A". If you don't get that, what I suggest you do is do it over again.

Now, for those of you that have those calculators, and these are the calculators without a tape, I would suggest you do it longhand because what you're going to find is by doing it without a tape you're going to make mistakes which means sometimes you're going to overprice the business, which means you're going to goof up. When you underprice it, you're going to irritate the seller if you happen to be a buyer. So, what I'm saying is either go to a tape or do it longhand. Why? So, you can find out what mistakes you make.

So, the end should be 3.39, and what we're saying here basically is we have come up with mathematically the fact that we are going to pay 3.39 years earnings. That's all it says – 3.39 earnings, and we arrived at it mathematically.

If you'll now turn the sheet over, 5-10 back of 5-9, you have now moved 3.39 up into that blank on the top under Section Five. So, it's "Hamel Business Value equals total value plus weighted business value times adjusted net profit." Total value is $190,000. You plug in the weighted business value of 3.39.

Now, what you do first is you multiple the weighted business value by what? Your adjusted net profit. Once you multiply the weighted business value of 3.39 times the $126,800 which is the adjusted net profit from above, you come up with a value of what down below? $429,852, and what is that number? That is the number that we have assigned – that is the value of the goodwill. That is the value of bluesky. That is the value of what we call the intangibles.

Now, the one thing we haven't talked about that I'd like to mention what is bluesky? Well, if you happen to run into a company and the owner is asking for more than the assets and the company makes no money, that's blue sky. But, if the owner is asking for some additional money above what the assets are worth or hard assets like the equipment and the cash, some value above that, that's goodwill. That's real. That's what you're paying for the cash flow, the location, all these other things we just went through.

Once you have these two, we have $190,000 which is the value of the hard value assets, the goodwill is worth $429,852 – and again that's a little more accuracy than we really have. We add the two together. We come up with $619,852, but there's nothing wrong with rounding it off to $620,000. That's accurate enough.

Now, supposing we get to this point and we find out the profit has been running $100,000 and that's what the sheet gave us in Section One up here – net profit of $100,000. We added the other things in. We had a real net profit of $150,000. That was for the year 198x as you'll recall.

If you look back at your Profit and Loss Statement on 5-3, you'll find that what we have is a Profit and Loss Statement for the year December 31, 198x. Now, supposing instead of this being December 198x, realistically supposing this happens to be October or November of the next year which means we've already priced it based on the last year. Can we now sit down with the owner and the owner gives us the documentation that shows us that in addition to making $100,000 in last year, this company has gone up and had additional profits. It's now making $100,000 more than it was last year.

LESSON 6

In this section we're going to be talking about one of the most important things when you get involved in a business whether it's a start-up business, whether it's an existing business or even after you buy that company or get it started, you're going to find this key thing that's going to keep you going, the key thing also that's going to enable you to expand is knowing how to finance that business. For those of you listening to this tape that are interested in either expanding your business or maybe you're interested in starting a business, the only thing that's not going to basically apply in your area would be the first thing which is owner financing. But, you're going to find that the rest of these different items that we have in here will apply in all different areas of business.

Now, even though you haven't heard about a lot of these different techniques that I'm about to talk about on this tape, the thing I want you to realize we've been out working on the financing business in business for over 30 years now, and although the average technique that you read about if you're bought one of those crazy books on how to start to buy a business mention things like going to banks and using the Small Business Administration, you're going to find although we mention that and we'll be going through that in this section, you are going to find they are not material. We don't use those that often. We're normally using things like bank financing for short-term financing which we then try to replace with financing that costs us a lot less money and maybe gives us more time to pay it back.

The first thing you're going to run into is a thing called owner financing, and keep in mind there's three basic categories in areas of financing. Number one – we have a thing called owner financing. A second broad category that we're going to go into in this tape is a thing called supplier and vendor financing. Again, these are people that you're in business with and these are your suppliers, your vendors, people that you're supplying with goods and services. The third general category is going to be institutional financing. As we go through this in order to define it for you, we've divided into those three sections in this LESSON which is LESSON six, and then what we've done also is we have another section where we're going to go into a number of other financing areas that tie into these different areas.

Now, first of all, let's start off by talking about what happens if there's no owner financing. Well, for those of you that have very little money or you're out financing a business and don't really have a lot to work with, one of the things that's going to give you trouble if you don't have owner financing is the fact that it's going to kill your cash flow because you're going to find the owners in most cases are willing to carry back financing. They're willing to let you put so much down as a buyer of that business and then they will finance the 75 percent whatever it happens to be over a period of time.

When an owner is not willing to do that, they give you problems. Number one – if you look at page 6-1 what we're telling you is if there's no owner financing available, number one – lending institutions consider this a danger sign and will be reluctant to lend their money to you for two reasons. A – the owner is usually telegraphing the fact that he thinks that you the buyer can not run the business properly, or the business doesn't make enough profit to repay the loan. Remember also it lowers the value of business when you're buying it, and we talked about that in the section we discussed the pricing or valuation of the business.

The thing you have to realize in this area, and I want to emphasize this a number of times if you don't get the owner financing, you're going to have to come up with a bit of money of your own because the other type financing you have that you'd normally replace this with is five year financing at very high interest rates. As you go through this section, you're going to find if we get the owner financing, we not only have 10-15-20 years to pay for this, but we also have it at a lower interest rate which means you have more cash.

In most cases, when you go out to finance, if you're able to finance a business 100 percent without the owner financing, and without funds of your own, you usually find that the amount of money you have left is very little, and in most cases you're going to find you have negative cash flow.

For those of you lucky enough to go out without owner financing and still finance it 100 percent, you're going to find that you have a little bit of cash left, and what happens is during that five year loan period, if there's a little bump in the economy you're going to end up sinking your ship. I just want to tell you something, over the years, I've had an opportunity to work with hundreds and hundreds of people from our programs, and every one of them that went out and didn't listen to me in this area did not get the owner financing ended up having massive problems.

The basic thing you're going to have problems with is you're going to find this fantastic business. You're going to buy it, and for five years, you're not going to have anything. All of a sudden you're going to run into somebody else from our program. They went out and bought the same size business, got the right financing, and right from day one they had the great life. They had the good life. What are you going to do, wait five years to get it?

I'm telling you is I'm warning you if you don't get the owner financing, what I suggest you do is give the business back to the owner and side-step down the street. I don't like businesses when they don't have financing available. In our brokerage businesses, we wouldn't allow our brokers to handle businesses or list them if they don't have financing. Why? They're just too tough to put together.

Going down to B on 6-1, we're talking about the normal down payment, and what you're going to find with owner financing – the average owner in the United States is going to ask you to put down 25 percent, and they'll finance the other 75 percent. In this area we start to get into negotiation technique, and what we've talked about in this program is the fact that we don't like you to make an offer until you've talked to the other party at least three times whether you're the buyer, seller, agent, whatever you happen to be in this transaction. The buyer and seller should get together at least three times to verbally negotiate, and what happens is then during the verbal negotiation of your three or four meetings before you make the written offer the buyer and seller get a chance to know each other, have a chance to trust each other.

Now, over the years, I've been involved in selling a number of businesses I mean with me being the seller, and again, even though I've said I'd take 25-30-50 percent down, I was really kidding myself with the person I was talking to because I didn't know who the person was going to be that was going to be that was going to buy the company. Would I finance? Probably, if I knew and liked the buyer, but if we didn't know the buyer, if I didn't like the buyer, if I didn't the buyer, I wanted all cash.

So, this is the thing you have to keep in mind as you negotiate. If you find that you as the buyer are not able to get to talk to the seller because there may be a broker in the middle or something like that, what I suggest you do is figure a way to get around that broker or what you're going to have to do is consider buying a different business. Again, why not do that. There's more of them out there then you can possibly buy. So, don't get hung up on one specific business.

Now, as you start to negotiate, you have to realize there's only a few things that you're really going to be negotiating between buyer and seller. One thing is the price.

The other thing is what kind of financing you have available and the terms of the financing. Although we're not going to talk about it now, the other thing is will the seller stay for a while and train? And, we have three sessions with buyer and seller and maybe you're spending an hour or two each session, you're going to find in any one or two hour session that you do have, you're probably going to spend seven, ten, maybe 12 minutes discussing the details, and the rest of the time you're going to be getting to know the other party. So, don't get hung up on it. In fact, let's get rid of the word of negotiation. You're going to have a rap session. You're going to have a discussion session with the other party.

The first thing we do as we're talking to the owner, and again, we're trying to arrive at the price. We talk about it each time. The owner will say, "I want X number of dollars." And, we then try to find out how firm or soft that price is, and if they start at $100,000, we're asking, "Would you accept $90,000 or $80,000?" Try to find out where their hot button is, and then cutting it off at each meeting and trying to bring them down lower again using that technique. Then, later in the program, we'll be talking about using the balance sheet.

Now, as you start to think about this financing, what we're going to ask the owner is, "Would you like to have all cash? Would you like to finance?" Again, I know you're trying to get a "yes" response, but the thing you should realize is try to find out if the owner will finance, and most owners, if they are reasonable people and are starting to like you are going to say, "Yes, we will let you in with so much down."

Now, I'm not going to say some owners won't start off with 100 percent and want all cash, but why not talk to them, work with them, verbally negotiate, and once they get to know you, you're going to find most of them will finance. If they don't, you better beware. You better find out why they want all cash, and you're usually going to find there's some other problem here.

Now, the first thing we do is try to get 20-year financing when we're talking about the financing. Now, some owners are going to start off by saying, "Gosh, I'll give you one, two, three, four years to pay for it." And, most of them will also add that the reason they're asking for the money in one or two years is they're helping you. You should then go back to the seller and explain that if you have to pay it off in two years, you're going to have negative cash flow. You're going to have to add other money to the business which doesn't make sense.

Now, what happens then especially in the larger businesses over $50,000 many of the sellers have already talked to their CPAs and worked it out financially, and many of them are very smart people and they realize that if they don't give you the buyer enough breathing room on your financing, your chance of making it isn't very good. So, a lot of them will start with 10-year financing which is beyond what we normally talk about.

As soon as they start to mention 10-years, as you negotiate verbally ask them if they would consider going 20. Most of them will. As you get to the point where you have them out at 20 years, you're great. You're in a good position. If the person happens to be highly motivated and really wants to sell and they're a 10 out of 10 on a scale of motivation, I'd suggest you try to push it out to 25 or 30 years. Now, in doing this you're not going to pick up a lot of additional cash flow on the business, but again, maybe it's just principle.

Now, remember as you do this and we're asking to pay it off in 20 years or 25 or 30, it's 20 or sooner. That gives you the opportunity as the buyer to pay it off sooner and not have a penalty by having to pay maybe all the interest because what we're trying to do is get you the maximum amount of time to pay for it, and if you decide because things are doing well or you feel better without financing, you can pay it off in five years or whatever you decide to do, but give yourself a lot of breathing room.

If the owner then backs off or balks or refuses when you're asking for 20 year payments, and he backs off and he says, "Look, I want to retire 15 years from now", what you say to him is, "Look, let's amortize", and by amortizing we're talking about let's have nice equal payments as if we were going to pay it off over a 20 year period.

Now, what we're going to find is it's not going to go 20 years and the owner wants the money in 15. Now, if the benefit to the buyer is to get the longest payments possible as if it were going to go 20, what we do then to satisfy both the buyer and the seller we do a thing called ballooning it. In other words, we will have a due date in 15 years, and we end up with a balloon payment. What does that mean? That means we make nice equal payments starting from year one as if we were going to pay it off in 20 years. At the end of 15, since we still have five years to go there's going to be an amount of money due that we still have to pay over the next five years.

What we do then is have a due date. All the money becomes due at the end of 15 years, and we have a thing called a balloon which is a large amount of money which is money you owe for the next five years, due and payable at that time.

You're going to find that a 15 year balloon is not going to hurt you bad, too bad in business. You're going to find though that we don't like you to balloon or end up with a balloon payment under ten years, and a lot of you are going to run into balloon payments of five, six, or seven. I'm trying to warn you, you're going to get in trouble. Why? Because a business is very difficult to refinance because once you refinance it, you're not going to have the big basic thing you had which was owner financing. So, what I want you to do is consider one thing – try to get it out to at least ten. By that time, you'll have paid down the loan. Inflation will have made the dollars a lot cheaper, and you'll have a number of things that you own free and clear. So, if you did have to finance something or refinance something, you can do it and you're not going to get hung up. But, remember – no balloons under ten years. If you do that, you're going to become another sad story, another horror story.

As soon as you've worked out the period of years, and again, you're doing it over three or four meetings, and again, if you get it up to ten years in the first meeting that's fantastic, and then move it on meeting by meeting as you verbally negotiate with the seller.

The next thing you're going to have here is a thing called the interest rate, and the thing that goofs many people is many of you offer too high and interest rate. Remember, the repayment period on a loan can be 10-15-20 years. Even if the going interest rate is high and it can be, it probably will not remain that high. Banks tend to give us all a feeling in the United States that interest rates are always going to remain at the level they're at or go higher.

We usually recommend paying only seven or eight percent interest on carry-back. Naturally, as a buyer if a seller's highly motivated, why not offer six? If you happen to be the seller on the other hand, let's face it, this program's addressed to both buyers and sellers, you might want ten percent or twelve.

But, keep in mind one thing and think about this especially if you're the buyer negotiating with the seller. Ask the seller, "What has the average interest rate been over the last 20 years?" And, most of them will agree as they search their memory that the interest rates only been six or seven. So, what you have to realize is in most times even in the worst times when the prime rate went up into the 20s, most owners were carrying back financing at nine or ten percent. As the interest rate went down below that, we got it down to seven, eight and nine percent interest again.

Again, we are not in the business as business owners to charge interest rates that banks do because we don't want to end up destroying the buyer. So, even though some sellers may start off at a higher interest rate, you're going to find by negotiating which is just verbally talking to them, you're going to be able to get them down a nice interest rate, and what you're going to find is it will improve your cash flow which is what you're after.

Now, once you have arrived at the owner financing, and again I want to tell you something – most of you don't spend enough time working on the owner financing when you're buying existing business. Now, since the owner financing represents 75 percent of the total financing that you need, this is the mistake you make. You get so hung-up on the down payment financing. You get so hung-up on working capital which are the small numbers, but you don't take care of the big one, the 75.

If you set up in the 75 percent financing for a nice long term at a very low interest rate, you're going to find there's enough cash flow let so it's easy to finance the rest and also have money left. In almost every case when I'm working with you and you've come back to me and big tears in your eyes to tell me you can't finance the business you're working on, it's usually because the basic financing which is 75 percent of the total value is the one you skipped over, and what you have to do is concentrate on the big number. Once you have the big number worked out you're going to find that the other numbers fall in. Think about it from a common sense standpoint. Wouldn't that make sense? And it does.

The next thing we have that we get involved with as a general category is a thing called inner business financing, and we're talking about actually having people that we're doing business with finance us. We're talking about suppliers. They supply us with goods and services. These are people we're supplying. Why do they do this? To keep us in business because we're supplying. We're a good source of whatever their product happens to be or they're trying to sell to us. In many cases, we are their customer.

Now, the first thing you're going to run into in any business financing as we talk about financing categories or areas of business whether it's on start-up or whatever – this works on start-up it works on expansion, it works in all areas – the first one is unsecured open book trade credit, which means people will come to your business. They will then provide you with credit. They'll let you pay in a week, two weeks, a month. Again, as you establish better credit with these people, they're going to give you longer and longer to pay for it. But, the first one we're talking about, category one, it's due in a few days.

The next category, the one we run into most often is a thing called extended trade credit which means we're paying 30-60 days, 90 days, more than normal, which means we have more time to pay for it, and what you're going to find is we can use this also as a source of financing because what you're going to find and we talked about this example in another section of this program - you're going to find that on the average, you have a thing called accounts payable, and they're $100,000 and you have to pay them every so often. In fact, if you want to make it easier, why don't we go back to the original example we used in one of the other sections on creative financing and we'll talk about a business that had $200,000 of accounts payable.

In that business we had $200,000 of accounts payable and they were due in 30 days. Now, again, we keep talking about this is the fact that some owners pay cash and they think pay in 30 days gives you bad credit. We're also going to find that people who pay in 30 days think people that pay cash are stupid, and what you're going to find is 30 days although it's a standard in the books, as you get out in the real world, you're going to find that you can get 45 days credit and 60, 90, 120, 180.

On the other hand for those of you non-believers that think that everything's going to be 30 days wait until you get out into the real world and find that your customers are coming to you and they're going to ask for 60 or 90, and what you're going to find is if you don't keep the receivables and payables balanced out, you are going to end up going to the bank to have to borrow money.

As we are able to extend credit, and let's say we did have $200,000 and it was due in 30 days, if we are able to extend that another 30 days, we're going to end up with another $200,000 of working capital that we can use. Although we use a large part of that for working capital, as you become more knowledgeable in buying businesses, you're going to find that you don't have to put all the money down.

If the owner wants $25,000, you can always give them $10,000 down during the escrow or closing period, and then pay them the rest of the money maybe 10-15-20-30 days after the close. You may even have to make it 60 days after the close. How would you pay for it then? Well, as you get your credit extended out say for an extra 30 days, the supplier money that you normally would have paid to the supplier with that period which is not due now because you have more time to pay for it, you could use that money to pay off that loan. Again, we'll talk more about that later.

The next category is long-term open book, and this is credit where it's due in six months or several years. When we run into this quite often is when we're borrowing money from a supplier, and we're borrowing money for the down payment. We're not talking about extended credit. We're actually talking about borrowing money from the supplier, and what happens is they want us to pay it back in six months, maybe several years. Sometimes it's only called when the customer drops the supplier. In other words, your supplier's going to lend you the money say when you're buying a business of for expansion or starting a business. In many cases, they don't want you to pay it back for a very good reason. What they'd like you to do is be kind because you happen to be a good customer. A way to tie you to them is to lend you money, and you're going to find that as long as you're doing business with them, you don't have to pay it back.

The other thing you're going to find especially in dealing with suppliers, if they do lend you money, very seldom will they ever charge you interest which is a very good way to go because you can improve your cash flow.

The next category is the inventory sent to the customer on consignment, and supplier retains title and control. That's what we're after because in the area on pricing where we talked about pricing or valuing a business, the thing we had problems was the fact that you have to really pay yourself a return on any amount of money that you have invested in inventory, and wouldn't it be nice to have $100,000 of inventory and not owe any of it, not to have to pay yourself a return, not have your $100,000 tied up in the inventory? And, one way to do it is have it there on consignment which means basically there are placing that material that inventory in your place of business, but you don't own it. What happens is at that last moment if somebody buys it the money is handed to you. You then give them the title to it and or possession of it, and you then end up paying the person that has given you these goods on consignment, but the great thing about it is you are basically selling something that you don't have any money invested in.

You're going to find in business if you want to become very successful in business, you don't really want to own inventory. You don't want to own equipment. You don't want to own anything because in a business you really want to understand it, and we're going to go through this a number of times. What we want you to understand is all we want you to own is what? The cash flow. Who wants to own all these other crazy things? You want to own the cash flow. You want to own the money. That's the purpose in business. As we say, that's the bottom line.

Inventory sent to the customer, again, we're on number five, using a field warehouse. In business today, I can't predict where you're going to be whether you're going to be the person as a supplier or the person receiving the goods, but what's happened over the years is many people have abused a thing called flooring which I'll talk about in a little while and what happens is somebody will come in and they abuse flooring or they abuse consignment, and how do they abuse consignment? Well, people with consignment goods and they give you these goods to show and sell, they don't want to leave them there for four or five years. What they tell you basically, is they're going to put them there on consignment, but what they'd like you to do is sell them in 60 days or 90 days. When that doesn't work too well, many times they will convert consignment and call it flooring. When they call it flooring, they're doing the same basic thing as they do in consignment except what they say to you is, "For 60 days we're going to floor you, and there's no charge. Then, after that we're going to have a rate."

For those of us that are having problems and need more consignment or they need more flooring, we will then go back on the counter attack as we negotiate and ask them to set up a field warehouse. A field warehouse, and we're going to get to the definition in a short while – a field warehouse basically is a situation where maybe your credit isn't too good, or maybe there's some special financing with a bank which I'll talk about later in this section, but what happens is they may take a token amount in the back of your business or the back of your warehouse. They may fence it off. There maybe a person from a warehouse company that will be in there, a warehouseman checking the goods in and out.

As your credit improves, you're going to find that they will turn the actual warehousing control over to one of your people, and then as your credit gets even better or you have a better relationship, they'll take the fence down.

What we're after is we try to get people to set up a field warehouse and have the supplier, the person supplying the goods, supply it. We also get the supplier – instead of having to go to a bank and pay a large interest rate – we ask the supplier to provide this, and naturally trying our supplier to do this at no cost. What we end up doing by doing it this way if we get it at no cost, we end up getting consignment by calling it a thing called field warehousing, and you may say, "Gosh, you're Mickey Mousing this area, playing games." Well, it may be a form of business playing or business games, but the thing I want you to realize is this any worse than the companies you're working with and they're telling you that basically you had consignment and it's now going to become flooring. What you're trying to do is get the consignment to go back to a thing that doesn't cost you anything, and what are you going to call it? One thing that we use quite often is a thing called field warehouse.

Six – a dealer's accounts receivables financed by the supplier. Later in this section, we're going to talk about financing accounts receivable, going to a person, a factoring company, going to a bank, going to a finance company, and actually borrowing against accounts receivable. Did you ever think of going to a supplier and having them finance them? Again, what you can do is you can put them up as security. You can borrow against them, but the fascinating thing is most suppliers won't charge you interest on it which means you save a ton of money if you have to borrow on receivables.

The next thing is the accounts receivables are sold to the supplier. Later in this section as we talk about factoring, you're going to find that you can take your receivables as you receive them and sell them to a factor o n a daily basis. What happens then is they convert those to cash, and you can use those for working capital and running your company, but did you ever think of going back to your suppliers and selling to your suppliers? Because if you do this you save a lot of money because factoring could be very expensive. If you can get your suppliers to do that for you, you're going to find it works very well.

You're probably wondering why suppliers and other people are going to do this. You have to realize that you are the customer, and you're always right. For those of you of little faith, as you go through this section and don't believe this can be done, as you get into business, you're suddenly going to find within a couple of months that the things that you didn't believe could be done are going to be done. How? People working with you are going to come to you for this type financing. What I'm trying to get you to do is go out and get as much as this financing as possible before they come back on the other side and get it from you because he or she who doesn't listen to me, and doesn't go out and get this financing and get more of it from the other person before they get it from you, whoever doesn't do that has to go where? You have to go to the bank.

Whoever's at the end of the line and is not getting some other type financing from another person in business is going to have to go to the bank to borrow money, and what you end up doing is you end up being in the banking business and you don't want to do that. If you haven't found out why, you will as you get into business.

The next area is the supplier lends the equipment to the dealer, and if you get involved in grocery stores, convenience marts, a lot of you have a feeling that in the big supermarket that the supermarket chain owns everything, and you're going to find that the ice cream boxes are owned by the ice cream companies. You're going to find the milk boxes and other boxes and shelving in there are actually supplied and given to you or loaned to the person that owns that business. Why? That's one of the conditions they have in that type business. If you want the shelf space, if you want to put your product in, then you supply the container, the racks or the freezer boxes or the refrigeration boxes.

If you're one of these persons that likes to go out and buy this equipment, I think you're crazy, and you're going to say, "Gosh, if I go out and do that they're going to charge me a lot more." No, they're not because what they're doing is they're trying to buy themselves a location, and if they then end up buying a location and raising their price what's going to happen is you're going to replace them with somebody else. Keep in mind one thing, there's always more people trying to enter any one area of the market then there are openings, and what the smart people do are the people do with money is they buy their way in and that's why we're able to get financing. That's why we're able to get a lot of extra things as long as you know what area to go after.

Supplier leasing equipment to a dealer – now, again, you're going to say, "What do you save on leasing?" On the average lease, when you're going out to buy new equipment or even picked up used equipment, you're going to find the lease payments are one of the most expensive types of financing you're going to get from a bank or finance or a leasing company. You're also going to find the terms are three, four, five years normally, maybe a little longer, but usually that, which means that the amount of money you're going to have to put every month to make these payments is horrendous.

You're going to find that by going to a supplier many times, you're going to take this large piece of equipment, let them buy it, and you can lease it back from them. When you lease it back, we usually try to keep the interest rate very low. As a matter of fact, what I want to tell you is we always go after paying no interest because a normal interest rate paid from business owner to business owner, any type financing or any type of credit is zero.

Now, I don't want to put this down and say, "Well, gosh, always go for zero." If you find that you have to go to the bank, and the bank's going to charge you 14 or 15 percent or whatever the amount happens to be, and your supplier wants seven or eight, well, I'd rather pay zero. But, if push comes to shove, and it's the only financing I can get and it's less expensive than the bank financing, don't call me and ask. What I want you to do is go out and get it.

The supplier sells the equipment to the dealer on a time plan, and again, if you go out to buy equipment your payments are going to be very high, and again, the amount of time you have to pay for the equipment is not a long period which means your payments per month are going to be very large, not an easy way to do it, but again, it's the same thing as vendor leasing. Go to the supplier. Let them buy it, and set up a time payment plan with them, and again, the interest rate is normally nothing or very little. For those of you with little faith, if you don't believe people will do this, again, people eventually are going to come to you and have you do it for them. Why will you do it? Because the customer's always right.

A cash loan to buy equipment – yes, a lot of times we'll need cash and instead of going to a bank, we'll go to another person we're in business with or working with and borrow the money from them.

A short term note – the only reason I put this in there as number 12 is the fact that with a short term note, what we're talking about is possibly paying back a supplier for money they loaned you for working capital or to buy a business. Quite often you're going to find that the owner of a business when they're lending you money will not ask you to sign a note and you as the person borrowing it, very nervous, and you wonder why you don't have to sign something. The reason they don't ask you to sign is say you're borrowing, $30-40,000 maybe $50,000 – your company that you're buying already owes $80,000 or $100,000 just on the goods that they delivered that you didn't pay for, and on the goods they deliver, they didn't ask you to sign a note. So, what you're going to find is it's sort of pretty loose. But, if you do insist that you want to sign a note, fine, sign a note. That's the only reason I mentioned it here.

The next thing is a term loan to a dealer for any purpose. I hate to mention this, we have not only gone out over the years and borrowed from other people in business for business purposes, I haven't done this personally, but we have a number of people in our program that during times when money was very tight actually went to suppliers to borrow money for a home. Although you may say, "Gosh, how could I borrow $100-$200-$300,000 from a supplier?" Well, you have to realize everything is relative, and maybe on a $300,000 business is not practical. It's not going to work. But, if you're working in an area of business maybe where you're doing five or ten million a year and one supplier is doing one or two million with you or three million, you have to realize the amount you're borrowing probably only represents the same amount of the goods you're buying from them every month. In fact, the amount you're borrowing in this area is not much more than what they deliver to you in goods. So, they trust you in that area. So, you have to think of it from a relative standpoint. Even though some of these numbers are a little larger than you're used to working with.

Equity investment in the dealer's business, and for those of you of little faith who don't think you can get the supplier or vendor to lend you money, I always give you a little tricky thing and say, "If you don't have any confidence in what I'm teaching or trying to project to you, why don't you go out to a supplier or vendor and say, 'Look I'd like to borrow $50,000, but I don't want you to have no security. I'll give you a note, but I'll also give you 25 percent of my business.' Why don't you do that?" Once you then have secured the money from the other party and you're about to close and take over the business, why don't you just turn to them and say, "You know I've given you 25 percent of the business for you putting up the money. Would you have forwarded the money if I didn't do that and give you part of the business?" In almost every case they're going to say, "Yes, I would." Which means you just gave away part of your business, but for those of you with little faith, if you don't think it works any other way, try it with a note.

The last area is flooring, and again flooring is something that we already mentioned, and what we're doing here is we're talking about flooring goods. What they means it they're delivering goods to you and it's sort of like an offshoot of consignment which means they are placing automobiles with you, refrigerators, stoves, and instead of having you pay for them now, they are flooring them.

Now, we're going to get to the actual definition later, and when they are flooring them, again there might be an interest rate due in two months or three months. What they end up doing is saying, "Okay, the first month's flooring is free." Now, that is not always the case because with flooring you may find they are delivering the goods. They are basically keeping title of them, and what they are doing is they are financing for you. Later in this section, I'm going to show you how banks do the same thing with a thing called flooring. I'll show you how that works and you'll have a more complete definition.

The next area and the one we've been talking about is our third category – our third general category, and it's called Lending Institution Financing. In other words, working with banks or working with the Small Business Administration. These are the institutional type financing, and if you've already gone through the pricing section, you'll notice this is the same way we break it down when we're trying to analyze a business to try to figure out how much it's worth. What kind of financing do we get? And, one of the categories we do get a lot of financing from is lending institution. Again, you're going to find as we go through the program that we usually try to convert this to something we can live with a lot better.

Let's get through the types of loans here on 6-5, and the first type loan you're going to find is a simple commercial loan. It's usually a loan for 30-90 days based on a financial statement, often unsecured.

Now, for those of you that buy a lot of real estate or have been involved in a lot of real estate, you're going to find when you buy real estate they're going to put a lien on your real estate – date of trust, mortgage, something like that. The thing that's going to fascinate you in the business for those of you with little faith, you're going to find that in many cases, the lending institutions are lending you money and it's not secured. They're not asking you to put up something in security. There's always good news and bad news. Of course, the bad news in this area is you've also signed personally which means they can go after you in attach or go after any assets you have.

A character loan – these are made as individual rather than business credit. In other words, you're going in to borrow money on your business, and what they're really doing is lending money to you the individual based on your ability to do things. Again, you're usually signing personally here.

Over the years, I have signed personally a number of times, and I don't know how many times, but I say up into the hundreds or maybe thousands of times, and every time I have it has backfired on me. Today, my motto is, "If I have to sign personally, I'm not going to do it." Although many of you are starting out for the first time, I promise you in the next few years that almost every time that you sign personally it's going to end up burning you. Whenever you can, try not to sign personally.

Now, for those of you listening to this tape that are lending the money, I would suggest that you tie up everything you can. This is a difficult thing when you're trying to teach or educate people in a program like this. We're trying to protect buyers. We're trying to protect sellers, agents, attorneys, CPAs. I keep trying to tell you over and over again, let's go after win-win situations. Let's go after situations where the buyer and seller both make out. Why do we have to rip-off the other party?

I've been in business many years, and I've done very well. I've found out one basic thing. You can make more money honestly in business than you can dishonestly in spite of some of the soap operas you watch.

Installment loans – again, these are used for many business purposes. I'm sure many of you know what an installment loan is. You've been involved in them. And, they're usually used by larger banks. As loans reduce, it's possible to refinance it at a better rate. The loans may be tailored to a seasonable requirement of the business, and you're going to find as we get into the program that in certain business especially like retail maybe around the Christmas Season, you're going to have a special requirement, and we'll get involved in that as we cover other categories.

The second part and we've turned to seven, we're talking about lending institution financing. One of the first things we have is a short-term loan which is one year or less. These are usually easier to get than intermediate loans which are one to five years. These are often unsecured. As we're going in we're asking for a 90 day loan. We're normally asking for a working capital loan. Again, working capital may also constitute part of the down payment. Why don't we say it's down payment? Most people don't like to hear down payment. They don't like to know we're borrowing that part of it, and for those of you bankers that are listening to this tape, I just want you to realize that the people we educate if they follow the complete program will not only end up financing a business 100 percent or close to it, but they also end up with a large percent of cash left over and what we're trying to look for is usually 30-50 percent of the cash left, and the reason we've done that is most banks we work would like to see at least 30, and since we tend to be a little more conservative, we try to push it up to 35-40 or 50 percent. It is possible mathematically. Now, remember these are easier to get. They're often unsecured.

Once we've gotten these 90 days loans, you're going to find that once you've renewed it and what will happen is you go in every 90 days, and the bank then will ask you to pay interest and then if you want to renew it you can, or pay it off, and if you've been a good boy and good girl, they'll renew it for another 90 days, and you don't have to see them for another 90 days.

Once you've done this a number of times, the banks will normally increase these and make these 180 days so they don't have the processing problems. I just want to say one thing. I had a few of these over the years, but I always feel bad about them because I feel like something's hanging over my head. It's a loan that's easy to call. It's a loan that may not be renewed, and usually if it did come up and not be renewed it probably would be at a time when I was having problems and I couldn't repay it. So, try to get these paid off as soon as possible. Also, if you sign personally, try to get these paid off. It's just good business sense.

Now, lending institutions financing – the next one is intermediate credit as we go down to section three here and we're talking about loans that are basically one to five years. We're using it for capital for other than temporary needs. It's used to purchase equipment, existing businesses, provide additional working capital. Again, we're trying to get up to five years, and although I say a range of one to five years most of the loans we work on are five year loans.

While the loans in force, you'll have restrictions on managing your business to protect the lender against drastic reductions, and a lot of times bankers will go down and visit your business at least once a month. What we try to do is set it up so that we see our bankers once a month, maybe have lunch, and then take them to see the business, and you're going to find then at least the business is going to be running the way it normally is. If you leave it up to chance, I guarantee you everytime the banker walks in it will be that day of the month that everything got screwed up. I don't know why that happens, but it does.

The other thing we should be talking about here in lending institution financing – one you start to think that you want to start a business, buy a business or may you want to expand your business and you're going to need bank financing, institutional financing, what I'd like you to do is go down to the bank and start to get to know some of the bank officers, have coffee with them, have breakfast, get to know them, play golf, whatever it happens to be. Give yourself lead time maybe three, four, five visits. Get to know them. The reason for that is the same as your negotiation between buyer and seller. It's very difficult for a bank officer to sit there and feel good about the loan you're asking for when they just met you. It makes it a lot nicer if you've gone in and laid the groundwork. You've done your homework. Again, you're just being nice to your local bank officer.

Again, bank officers like to make loans to people they know. They like to make loans to people they trust.

I should've made this number one. They like to make loans to people that can repay the debt and repay it safely which is the key to working with bank officers because they don't like risk. I understand what they're talking about.

The next thing as we go to 6-9 on lending institution financing – we'll talk first of all about equipment financing, and you're going to find in a business you go to a bank or a lending institution and you can borrow money against the equipment. It will be secured by the equipment, and again I'm just giving you averages here and it's going to vary year by year. It's going to vary by the equipment, and it's going to vary all over the place. But, generally we're talking about borrowing about 50 percent of the appraised value.

You're going to find as you become more knowledgeable in business, you can figure out ways to borrow more than 50 percent, but 50 percent is what we can get. You're going to find there are techniques to borrow more.

The next thing is the inventory financing. We can usually, again, borrow about 50 percent of good inventory. Many institutions are wary because of control problems. You may be able to minimize a problem by placing an inventory in a bonded or controlled warehouse set-up. When you do that, we have run into banks and lending institutions over the years that will go up to 80-90 percent of the value. What are the lending institutions looking for? Security. In other words, they'd like to know that if they're going to lend you the money against an asset that they're not going to get ripped-off, that they're going to be repaid.

Accounts receivable financing – in this, we already talked about this generally, you pledge or assign all or parts of your accounts receivable security, and you can borrow a percentage of the amount pledged. In some industries you can borrow 50 percent. We find nationally the average is about 80 percent. So, you can borrow against your receivables, and incidentally, you're going to find that you can borrow against the accounts receivable when things are going bad. We've seen companies borrowing on receivables when they're going down the tubes. As a matter of fact, most of the accounts receivable that we run into in the United States, these are companies that are in trouble. Why are people able to lend money against receivables or even buy them from you? The value of the receivables has nothing to do with how well your company's doing. What it has to do with is how good are the people that owe you money through the accounts receivable program, and if they are good for it and they've been paying on time that means it's something you can borrow against easily, that you can finance easily.

It's a good source of cash flow for your business, but I do want to tell you one thing. It's a danger area because once you can start converting your receivables to cash and do it immediately; many business owners become very weak. So, I would like to suggest that you use that as a last resort unless you're in an industry like the garment industry where it's a way of doing business, but in most categories we find that it's a danger sign.

Accounts receivable factoring something we mentioned before – in this area a person called a factor buys all of your accounts receivable as they arise. They are purchased at a discount, and the cost could be very high. But, keep in mind, what they're doing is buying them here. They're buying them from you. So, instead of borrowing against them, you're actually going in and selling them to somebody and receiving cash from them the next day or a couple of days later.

Borrowing on contracts not performed, and this is an area that a lot of people are not aware of, but you can borrow on contracts that you haven't performed on yet because on accounts receivable, you're really borrowing on what? On something that's already been done. We're now talking about borrowing on contracts not performed, but the thing you have to keep in mind, you can't go to normal lending institutions. What you're going to have to do is go to your Yellow Pages, and look up "Other Financing Companies". These are companies that may charge a little more, but they're not the banks that do this. Very few banks that I've ever run into get involved in this area. They like to borrow on something you've already done, or lend you money on something you've already done.

You're going to find that you have to go to regular finance companies and they're listed in the yellow pages. If you go to them, you're going to find the rates are really not that outrageous. They're very nice people.

The next category that we're talking about on 6-11 is a line of credit. An internal formal understanding, or it can be informal, between a businessman and his bank. The bank agrees to grant loans up to a maximum amount often unsecured. Used in business with a seasonal need for short term funds, and again, we're talking about the example here – a retail store during the Christmas season.

Now, what you may do is you may just decide you're going to go out and have working capital which means you're going to have $100,000 sitting there all year. Now, if you happen to be in a business where $100,000 is only required maybe in October and November and part of December, why have that money tied up there continually, and you may find that it may be better to have a line of credit which means you go to the bank, talk to the bank, and they will grant you what we call a line of credit say up to a $100,000, which means you can borrow up to $100,000, and you're really only going to be charged based on how much you borrow which is a very good way to go. It also helps you develop a better relationship with your bank because that's required to get that line of credit. Incidentally, if you do get that line of credit, use it because if you get one for $100,000 and you don't use it, you're going to have a hard time getting it again because the banks in the lending business to make money.

Once you've used the $100,000, then you're going to find if you've been a good boy or a good girl, you can go back maybe next time and get $120 or $150, and the way to build up is your ability to borrow the line of credit is once you do get the credit, use it.

Line of credit on home, and this is a new program that just started recently, and you're going to find that a home is used as security for a loan. What will happen is they will take a second mortgage or a trust deed for security, usually not in third position. They want to be in second position. You pay an upfront fee, and then a percentage above prime on the money borrowed.

Now, you're going to say, "Gosh, why are you saying that we should get a line of credit against our house?" Well, if you're in an existing business and you have a short-term need or maybe you want to have this available just as back up just in case something goes wrong, I suggest you think about this. A lot of you out there that are buying existing businesses and you're living in a certain level home, maybe $100,000 home, when you go out and buy a business and say the business is making $150 or $200 or $300,000 a year, I hate to tell you this, within a few months after you own that business, you're not going to want to leave in your sweet little home that you were satisfied when you're making $25 or $30,000 a year, and you're going to buy a larger business. But, again, you know my feeling on using your home as security. It's a court of last resort, and usually it means that something's wrong with what you're doing in business. But, again, there's nothing wrong with having a little extra back-up, a little extra protection. Usually when you do that it doesn't happen.

Warehouse receipt loans – we've talked about this, and here's the definition. The inventory's delivered to a professional warehouse where it is stored on the premises of the buyer. The receipts are issued to the buyer to give the bank to give to the bank as collateral for a loan. When the orders are received, the borrower will buy back from the bank enough warehouse receipts to fill the order. So, it's a bank financing device. What we've talked about before was using a supplier, and the main difference here is we're paying the supplier normally no interest which means we don't have a cost on it, or we're paying them very nominal interest rate which is a lot less than you pay at the bank.

Floor planning – we talked about this before also but not with the definition. We use this to finance inventory such as autos, appliances. The dealer has possession of the merchandise but the title remains with the lender. In other words, you'll have possession, but the bank will have the title. When you the dealer sell the unit, you pay the lender the amount due – very easy. Again, what I was saying here is sometimes when you're working with the person that is leaving the goods there, they will allow you to floor plan and they'll do it and not charge you anything for the first 60 days. When you're working with a bank, they charge for the total period.

The next category is 6-13, and we're talking about lending institution financing long-term because what we've been talking about so far is basically terms up to five years. Now, we're talking about loans from the Small Business Administration, and when we do this, we're talking about getting loans that will go maybe seven or eight years or ten years, and you're going to find as you look at this, you're going to find that these are guarantee loans, and what will happen is, again right now at the time we're recording the tape, the government was under law guaranteeing these bank loans for up to 90 percent of the $500,000. So, 90 percent is guaranteed by the government. The government for the last few years has been talking about raising this to $750,000. So, you might watch out for this.

Now, the loans again are usually for seven to ten years. They're usually two and a half to two and three-quarters over prime, and for those of you who think these are very good loans, before you go to the Small Business Administration even though that great book you bought told you to do it, I suggest you look at every other source.

Now, before we get down to some of the problems, let's just tell you that most of you think that just banks can provide this financing, but you're going to find that Controlled Data has a number of business centers around the United States. Yes, that's Controlled Data the computer company, and they have business centers around the country. They're very nice people, and you're going to find that they provide financing. They will work on SBA Guaranteed Loans, and they are easier to work with than the banks.

You're also going to find there's a couple of stock brokerage firms, and one of them is Dean Witter, and they are also able to provide these loans, and they usually process them very fast. The thing you're going to find in working with a bank, they tend not to like those type loans and the end up taking quite a long period of time.

For those of you going after SBA loans and you want to go through a bank, if you're in the Midwest, East Coast, Southeast, you're going to find a lot of SBA loans available. As you get to the West Coast, most of the banks there provide loans at the same rate or less without all the other red tape. So, most people just end up going with straight bank loans.

Now, let's take a look at the requirement here. You have to have evidence of the ability to operate the business successfully. So, you have to have some track record or bring somebody in with you. You can't finance 100 percent. They have requirements as to how much you have to put down, and you're also going to find they want additional security – your home. In fact, you're going to find in most cases, they want everything you have. So, you're going to find that maybe it isn't as good as you thought.

As you know right now for the last few years, the government has been trying to get out of the loan guarantee business, and we're just going to have to see over the next couple of years how these programs do. What you're going to find in most cases, the people that work with me have been through different programs stay away from government financing. Why? It takes too long. It's too difficult to get, and there's too many strings attached. Besides, there's too many other ways of doing it.

The next page 6-15, we're going to be talking about equity financing. Now, the thing I want to mention that I should've mentioned sooner is the fact that in this LESSON as you go through the book especially up until about 6-15, you start to lose more control and the financing is more costly. Once we get into the next miscellaneous section, you're going to find it varies by the type of financing you're going after, but generally the financing that is closer to the front of the section if you just want an easy rule of thumb is that the financing that's going to give you the best cash flow is the buyer.

The next category we said here under equity financing, we're saying venture equity high-risk capital. In other words, these people are coming in They're willing to come in a do more high-risk. A bank doesn't want risk. So, what you're going to find is these people are going to want a piece of the business.

Now, you're going to say, "Well, gosh, I don't want to give up a piece of the company." Let's analyze it. Would you rather own all of a company that makes $50,000 a year, or would you rather own 51 percent of a company, control of a company that makes $500,000 a year. This enables a lot of you that maybe would have to started with a smaller company to start with a lot larger company, and believe me it's better – not exactly starting at the top – but, it's better starting in the middle than it is starting at the bottom. It's a lot easier.

First category we have are small business investment companies called SBICs, and they're again listed in the yellow pages, or you can go down to a different section of the library and they have books that just cover all the SBICs in the country. These companies provide equity financing. They buy stock outright in convertible debentures, and C-1 down below describes a convertible debenture.

They also make long-term loans, we're saying five or ten but we've seen them longer than that, and for those of you that need bank guarantees – in other words the bank wants a guaranteer or a co-signer – you'll find people in these companies will do that for a fee and a piece of your company. They're privately owned corporations licensed and regulated by the Small Business Administration, and what happens is they go out and raise funds. They make loans to people like you and I, and then what they do is based on the loans they've set up and how much risk is involved, they're able to go back to the Small Business Administration and borrow additional funds from them based on how much money they have out, and the government then lends them the money at very favorable interest rates. They then relend it back to people like you and I at a little higher interest rate, and on the spread, they make a very good living. There's a lot of these companies around.

In fact, those of you who have gone to banks and the bank turns you down and says, "Look, we'd like to lend you only 20-25 percent of the value of the company. You want 70. We like to stay 20 or 25 because there's that risk there." If you want to work with that bank organization what you ought to do is ask them if they have a division of SBIC which is a joint venture or a risk division, and you'll find that most banks over the years – the larger companies, larger banks – have set these up, and you go to them and although the main bank that is not in the risk business turns you down, these people will say, "Gosh, we will lend you 70 percent but we're going to want a certain percent of your company." In other words, they want a share of the action, too.

The next area Minority Enterprise Small Business Investment companies MESBICs – they specialize in lending to minority owned businesses. They're also privately owned corporations licensed and regulated by the SBA. Those are minority SBICs.

Venture Capital Companies – again, if you want to find a venture capital companies if you go to the library, they have all sorts of books on venture capital companies. They specialize in different types of lending. You're going to find that although they have a glamour name and they're nice people to work with, you're going to find in most cases today unless you really have a lock on your company and put up a lot of money, they're going to want controlling interest in your company. The best that's going to happen is they're going to buy the stock outright or through convertible debentures which mean they can convert them as debentures to control on your company.

What we're saying here in section one is they're convertible to common stock of the corporation at agreed upon terms. In other words, they can convert them later and end up kicking you out. We don't like situations like that. We like control of our companies. They specialize in their areas of expertise. They usually want control, and as you go to the different books that list these venture capital companies, they're going to list who the officers are, who to contact, how much money they'll lend out, how much they have available, what kind of companies they lend to, and don't write to them. What I want you to do is give them a call, go over there, talk to them, and have a package ready on what you're trying to do. Show them houw you're going to repay it, what you're willing to give up. In other words, act professional and don't try to shotgun. If you're going to hit four of them, spend the time, spend an hour or two talking to these people and be prepared before you go there because these people are very successful people, and they're going to be lending money to things you're going to make a lot of money on.

Local development companies – these are local corporations whose main interest is expanding local industry or attracting new industry usually in smaller areas where there are not a lot of other funds available for business. No individual may own more than 25 percent. SBA loan limitations are a maximum of $500,000 for each small business, and what you're going to find is maturity up to 25 years, and you're going to find over all the years although I've heard of someone working with one, I've never got any details on it. I, myself, have never personally had the opportunity to work with them.

One of the last categories we have right in this general category is a thing called "going public", and again, the investment banking houses will handle the details, and what you should do is discuss in detail with all of your financial advisors. Also, don't do this at the last moment. Give yourself a year or two to start doing the publicity and other things involved. What I suggest you do if you have a good company and a good product, I suggest you go with one of the better investment bankers and even though they're going to charge a lot more, not a lot more but more than the smaller ones – you're going to raise the money a lot faster. You have more chance of raising it, and then as you need more funds in the future, you're working with the top people. So, I recommend going that way.

As you turn to 6-17, you're going to start getting involved in other financing methods, and the first one is a thing called a joint venture. I'm sure most of you have heard about that. Again, joint venture is usually for a year, sometimes for two or three years, but it's a limited life because most people getting involved in a joint venture that have the money really don't want to have something going on for too many years because they like to roll their money into some other investment. They don't want to tie it up for too long.

An example like this what we could have is we could have Party A – they're the manager, the owner. They usually don't have a lot of assets. Party B would be the joint venture, which is the investment owner. So, you have two parties, and the second party which is Party B ends up being what we call the silent partner. Again, the cash partner usually wants some control, but as you get involved in this, you're going find maybe they want 25-30-40. It's going to depend on weak the person is that's going to the person with the money. There's some hard-noses out there, and I'm again I'm not criticizing. I'm saying I would be the same way. They're going to want control as the silent partner.

But, for those of you going out to start for the first time that don't have a lot of money and are going to need money to expand, and you have to give up something, keep in mind one thing. Most of these people have a buy-out clause which means that although you may be giving up more than you want to in the beginning, you're going to have a chance to buy them out in a year, two years, or three years.

Again, why pass up good opportunities just because you're looking for an absolute. There are no perfect tens out there in business or in financing. So, what you're going to have to do maybe is give a little away in the beginning. Again, if you don't give away in the beginning anything, what you're going to find in most cases, you won't accomplish anything. So, be prepared to give away a little in the beginning and then as you become stronger and wealthier, then you will be in the control situation, but you'll never get there if you don't bend a little.

The next area, the limited partners, and what we're talking about is setting up a limited partnership and if you happen to be the person that we or somebody else is raising the money for, you the buyer of the business or maybe the person wanting to expand or the person starting a business would be the general partner. We would then put together, or you would put together a group of limited partners.

Now, again with the group of limited partners, you're going to find that they basically have no say in management, and that's what the law is. You're also going to find most limited partners want to get out in one, two, three, four, five years. So, you have a buy-out, and even though you may have a situation where you have people in with you, remember, they don't have a say in the business, and if you want to have absolute control and own all of it, you're going to have the opportunity in the next couple of years to buy them out. This gives many of you an opportunity with limited funds to either expand or buy a company, to buy something larger as your first stepping stone.

Again, the main thing is the buyer ends up with a business and the control, and also the investors make out. They end up getting tax benefits. They get a good return on their money, and if you're doing something that's middle of the road which is what we suggest doing, they don't also have a lot of risk.

The next thing is an ESOP. It's an Employee Stock Ownership Plan, and again, what we have here without getting into the details of it because there's a lot of information out there on it. If you want to go down to the library, they have all sorts of books and records and all sorts of pamphlets on ESOPs and how they work. They thing you have to realize with an ESOP, an Employee Stock Ownership Plan, this usually only works in companies where they have over $500,000 a year in payroll, but you're going to find an ESOP can supply equity capital, cash, or money to liquidate the owner. You're also going to find you can use it for expansion, but it does assist in financing an acquisition or for those of you trying to sell a company, it's a great way to go.

If you happen to have an ESOP, you're also going to find you may be able to contact one of the large merger and acquisition firms. Look in the yellow pages. Most of the better, larger merger and acquisition firms are also in the business of ESOPs. They have a division within their company where they handle ESOPs, a managed program to set them up. They're very nice to work. They can provide other types of financing, but they also can give you advice and assistance on how to handle financing using the ESOP.

The next one is an employee stock ownership trust, and it has different laws as to how that is controlled and who controls it and how it can be funded, but the key thing is it also is the same as number three in that you can use it for financing, and it's a great tool to use. Incidentally, one of the things I forgot to mention, it also is not only a great source of cash, it's a great tax write-off. It's also a great benefit for employees, and we've been involved in these over the years, and while they don't work too well with the people that are maybe in their 20s and 30s, but as people start to think about getting older, maybe at 40 and so, we find it starts to become a little more effective and they become more interested in how much they have vested in their stock ownership programs. We find they work very well.

Financing about one million dollars, A – there's two different categories. One is offshore financing, and I'm sure you've heard it time and time again, and we're telling you to contact National Business Marketing Corporation or National Business Finance Corporation, and what will happen is by contacting one of the companies that I own, they will provide information for you, and they will show you how to do this, or if you want them to do it, they can. There's two general sources we run into, and one is offshore which means it's basically could be through the Caribbean. It could be off the islands, off the coast of England, or you could be talking about the Pacific. But, again, what we like to do is sit down and talk to you and warn you about the difficulties in this area, and the fact that most of the programs that you hear about in these areas don't exist. In other words, it's just a fantasy.

The next one are European sources, and we're talking about working through programs. We're working with people in Switzerland. We're talking about Amsterdam, and also normally London. Again, there are different sources back there, and again, you end up with the same flakey-wakey factor. There are some that are good and that are real and do exist, and other ones that don't. For those of you that want to come back and ask me about sources of money from the people in the Middle East, the Arabs – we're always talking about the Arabs – I have a lot of friends that are Arabs, and in all the years that I've been working with these people, I have never worked with one that is in the financing business. I'm sure they are, but I'm sure what's happened over the years is they've turned the handling of the financing over to the banking institutions in Switzerland and also in Amsterdam. Again, that's just our belief.

The next thing is a CPA, an accountant, finance fees – a lot of you that go out don't realize the different levels of financing available in all categories. You're going to find A – if you start a business or buy a Mom and Pop, CPAs and accountants usually want a cash retainer in front. If you buy a business making over $50,000, they ask you to pay at the close of escrow. You're also going to find that most of them will accept payment after the close.

Now, why do they do this? Pretty simple, they'd like to have you as a customer or as a client, and they like ones that they pay their bills. They also like to handle larger companies. If you want to get this financing, just ask.

You're also going to find attorneys finance their fees, and again, I'm sure the attorneys and the CPAs and the brokers are going to come after me for even bringing this up, but since it is a source of financing, you should be aware of it. If you start a business or buy a Mom and Pop, again you have the same problem, they usually want a cash retainer. Why? Because they want to make sure you pay. Once you've established something like you buy a going business, you find out that you get to pay at the end of the close. They don't ask you for money upfront. Why? Most of the time, they assume you're a winner because you're buying a large company. You're going to be in a position to pay at the close. Why? Because you have this large company. You're also going to find they will accept payment after the close. They'll carry back a note. Some of them, attorneys or CPAs might even like a piece of the business. We usually just rather pay them. We have enough partners.

The other category we have here is the business broker financer fees, and we're in the brokerage. We also have a lot of good friends that are in the business brokerage. I'm sure they're going to kill me if they hear me talking about this, but you have to realize they will also finance their fees. The fee that we have in a business, in a sale, is usually about ten percent. This fee represents a large percent or all of the down payment, because although the average down payment on the smaller businesses is about 25 percent, as you start to get up in the business that are hundreds of thousands or millions of dollars, quite often the down payment starts to approach ten percent. In that case, it means that maybe you should start to be treating your business broker a lot nicer in the beginning because most business brokers do very well, and since they do well, many of them are willing to finance as long as they get part of it in cash.

The other reason they're will to finance, it helps to defray part of the taxes they have to pay especially those that are up in the higher tax brackets.

Number nine, we're talking about creating a note here. Now, we're talking about creating a note against real estate. What we do is we offer to create a note secured by the real estate you own, and you can use it as a down payment or you can use it as additional security. Somebody's worried about the business, they don't want to have maybe the total business in security and they'll ask you for real estate in security, or you can have a note with real estate as security.

What you have to realize, you say, "Gosh, I already have a first mortgage, a first deed of trust on my real estate." Well, that's fine. You can still put a second on it or offer to create a second in it. I'm not going to get involved with the tax ramifications, but the reason we offer to do it is you don't want to create it, put it on the business, and then use it. It is much better to create it in the escrow or closing. Again, you can discuss that with your CPA.

Next thing is creating a note on personal assets. A lot of people forget about this category. Offer to create a note secured by personal assets. Use it as a down payment or additional security, and again, by personal assets I don't care if you use all the clothing that you as a male or a female happen to have. I don't care if you take all the items you have in your garage – your lawnmower, your boat – whatever it happens to be. You're going to find that you can use personal items, and if you don't believe it, you ought to go out and find what the average buyer used when they bought that business.

Again, you don't have to put this in the offer in writing. Why don't you discuss this verbally in negotiation?

Next thing's creating a note against the auto. Offer to create a note secured by your automobile. Use it as a down payment again, or additional security. Even if it already has a loan on it or putting it up as additional security on an item. Again, we talked about the motor home, the boat, the plan, whatever it happens to be. Again, why do we use these things? Because as long as you get yourself in a position in the creation of this note, and you're getting in a business where you can pay that loan back and do it safely or okay. If the thing is too close, I'm going to suggest you not put anything else up. Why? You're going to end up losing it.

Refinancing real estate, and one thing you don't think about – many times the real estate that's included in the transaction has been around for ten, 15, 20 years, and although they may have started off with a 20-30 year loan, the loan only has five years to go. What you can do is refinance it, and by refinancing the real estate in the transaction, we can use the cash for working capital or as a down payment in the transaction, and that's done quite often also.

Sale and leaseback – we do this probably at least once or twice a month, and what we're doing here is we're selling the real estate in the transaction to an investment group for a price based on what? The return. And, what you're going to find is in the transaction, you may find that the going rate on what you're having to pick-up the real estate for is maybe $300,000. You may find that by selling it to an investment group and guaranteeing a return, you may be able to pick-up another $100-$200,000 in cash that you can use in the transaction. Again, we're not ripping anybody off. What we're doing is we're going to an investment group and we're selling them the real estate package based on not what we paid for, but we're basing it on what the return is we're going to be guaranteeing back to that investment group. Again, I use the word guarantee sparingly because we're trying to guarantee as little as possible. I also don't want you to think we're trying to rip somebody off because what we're also doing is we're fully disclosing what we're doing in each transaction. We're disclosing our profit.

Now, again, we're talking about using the extra cash to finance your business purchase, or working capital, or expansion, or it could be the start-up. On page 6-23, under financing, we have number 15 – industrial revenue bonds – which is another great source especially on financing start-ups. Cities and states will float bonds to entice you to move your new business to their area. They do this if your business creates jobs or creates revenue for the area.

A scenario over the years that we have found more start-up companies use than existing, and it's really fantastic because these bonds are at favorable rates to you. In fact many times the real estate that's involved, the land and the building, will be at a token rate – ten dollars a year, maybe a hundred dollars a year. You're also going to find that at the end of the 10-15-20 year period, whatever is agreed to, in many cases, they will actually deed over or turn over the land and buildings to you at a token amount.

You're also going to find that they'll set up the tax rate to be very favorable. They'll set up special incentives for people who want to go to work there. But, you're going to find it's good for start-up and existing businesses. Again, with a lot of manufacturing companies distributorships, you can find you can move to almost any area of the United States without influencing your market.

The next area, number 16, real estate guarantees, is a program that we've had for the last couple of years, and it's basically broken down into two areas. One time you're going to find that the people putting up real estate as guarantees on a business are going to ask for cash and the reason we have this program is a number of times, people that own a business are going to say, "Gosh, I'd like to have some other security than the business." Again, what we're trying to stay away from basically especially with sellers, is we really don't want to have to give them the security of the business and real estate or some other security. The reason for that is we don't believe they're entitled to that because why should we as buyers if I happen to be a buyer, why should I have to give the person, the seller of the business more security than they have right now?

In other words, there's a risk factor involved in being in business as a seller and if they're able to sell it to somebody else and take out the risk completely, I don't think it's fair or if they want to do it that way, then they're not entitled to very much interest payment on the amount of money they receive. But, on this, we have many real estate owners who will guarantee part of a business or all of a purchase, financing with the real estate. In other words, they're at risk also in case you goof up that business. So, we usually verify this and check it out quite carefully to make sure that our good real estate friends don't get ripped off.

They're usually asking for a ten percent cash return on the equity pledged, and they'll deliver land, apartments, shopping center, industrial – whatever you happen to want, and we have found we can deliver this by state, by area, anyplace in the United States probably in the world as a guarantee. Whatever the seller happens to want.

And, for those of you listening to this that happen to be sellers, this enables you as a seller not to have to worry about that transaction. You can either take it as additional security, or as a security instead of a security of the business. Again, almost picking and choosing what you want.

The next category is a category for those of you who say, "My gosh, I'm trying to buy this business, and I really can't afford the ten percent return. It's going to kill my cash flow." Well, there's another program we've developed the last couple of years with people that own real estate, and what we have here is the people, again, will guarantee all or part, but you're going to find in this case we're going to promise them or give them a six percent cash return on the equity they put up, and then also, tax benefits from the corporation or company which you can pay back to them, and also a possible piece of the action. Even if you have to give them a piece of the action, you're going to find every one of them or almost every one of them will agree to a buy-out clause.

When we get to the next page number 18, we start to talk about savings and loan guarantees, and we're talking about savings and loan actually placing part or all of their assets – not all but part of their assets – for a return. What will happen is we're saying the savings and loan will guarantee the loan on the purchase of the business for an annual fee. Sometimes they want a piece of the action. Again, we have found – we give them less often than the average individual a piece of the action. They don't ask for it very often, but quite often they'll go with five percent. So, instead of having to pay $10,000 on $100,000 real estate, in this case we're only pay $5,000.

Insurance company guarantees – an insurance company will guarantee the loan on the purchase of a business for an annual fee. Sometimes they want a piece of the action. In other words, you can have an insurance company with their massive assets put this up, and what it does is enable you as a buyer to put the transaction together because of the guarantee at a much lower interest rate. For those of you who are sellers, it enables you then to sleep soundly after you sell your business without worrying whether you have to take it back or not because it's been guaranteed by maybe one or more sources.

Trusts, pension plan guarantee – a trust or pension plan or fund will guarantee the loan on the purchase of business for an annual fee. Sometimes, again, they want a piece of the action. So, we're talking about all sorts of things that you never read about, but these are things that we work in, and the reason we develop these programs over the last few years is we don't like to have people come back to us and say, "Gosh, I can't do something for the following reason." Because it's always been our belief that if the business happens to be good, the concept good in starting a business, there has to be a way of doing it. We have found over the years, that maybe it takes us a couple of days or maybe a week to develop a program, but if we do have something or we run into something that really seems impossible, do come back to us, and give us a chance to maybe develop a program in that area, or maybe we have one.

The next category is a stock broker, and we find many stock brokers have many clients that will invest for joint venture, and most of you don't think about the stock broker because what they'll do is a lot of times they'll have a business owner and the business owner will go to them and say, "I'd like to invest my money in the stock market." Again, they don't have the money in the stock market all the time. Sometimes they'll pull the money out of the market, and it gives the stock broker a chance to make some more money, and you're going to find that quite often we can get very favorable rates. Very seldom do they ask for a piece of the business, but if they do you can build in a buy-out clause. Again, use your stock broker.

The last one in this category and probably one we should've used over and over again is Mommy, Daddy, friends, relatives, and again, we said probably we should've started here. Again, you don't have to borrow money from them. If you happen to have a friend, a relative, a mom, a dad, whoever it happens to be, a member of the family that happens to have a good financial statement or maybe better than yours, but just having them agree to a joint venture and go ahead with you, you're going to find you're going to open up all the doors to brokerage offices, to banks. If you partner then or a family member, whoever it happens to be, decides to back out later or maybe you back out, at least it's opened the door for you. In some cases, we find also we'll go into business with these people with a buy-out clause. All I'm saying is it's a fantastic source, and we think you ought to consider it.

LESSON 7

This is one LESSON in the programs that we put on in the last number of years that changes quite often, and the reason we're phasing out this more and more even going back to the first days when we started teaching programs and putting out books and cassette programs years ago, the thing you have to realize, we have never been into creative financing. Our basic goal and the thing we've pushed is the fact you go after nice simple things. Don't put together creative transactions. Go out after things that are straightforward.

The reason for that is most people in a transaction are not afraid of things they understand. As soon as you start to become creative, the basic thing that happens is you scare the other parties in the transactions. Professionals have to become very defensive because they don't know really what they're looking at. They keep thinking, "There has to be a hook there. There has to be some Mickey Mouse." And, what they end up doing is holding back their clients. So, what we try to do is stay away from creative financing.

If you've been a follower of our program ever since we started many years ago, you will find that the creative financing section probably has as much or more change than any other section in the book that we've changed and modified and taken things out. What we're trying to do as we improve the program is get it to the point where we really don't have anything that can really be called marginally creative.

What we're about to go through on this tape in the different sections, and I don't really consider creative because you're going to find each one of the techniques that we have here have been used for a number of years and have worked very well.

The normal M.O. or method of operation that I follow is that I will then keep the things we're about to go through in this section over the next year or two. As we then get more experience and they become more accepted as standard ways of doing it, we will move them into the normal financing section.

My goal over all the years in teaching has been to get to the point where someday as I'm phasing out of teaching and retire or whatever I decide to do or pass on to the great beyond, is to have nothing in the book that has to do with creative financing. Everything is by the book. Everything is by the number.

As we go through this section, I also want you to realize, again, as I already said, it is not creative. It is something that we do everyday. The thing you have to realize it's a little out of the ordinary.

The other thing you're going to find as you go through this section, don't be confused by the fact that we call it creative financing. You may call is miscellaneous financing.

The techniques I'm also about to take you through are techniques that we use quite often, and you're going to find can be very beneficial for pushing that transaction along.

Keep in mind as we go through the ideas here that these work on buying a business. They work on selling a business, and for those of you that don't realize it yet, if you're in the process of selling your business, if we can teach thousands of buyers every couple of months how to buy a business and finance it 100 percent, you have to realize if you flip it around the other side and you're seller, you're going to find that you can actually sell that business and pull out all the cash.

Now, if you decide not to do that, you're going to find in this section there's two techniques that you can use as additional security. So, if you do decide to finance that business that you're selling, and you find that the buyer maybe isn't strong enough, you're going to find that there is available now on the market, financial statements that the buyer can rent which means between the buyer and the joint venture partner which is worth X number of hundred-thousand or million dollars, you the seller of the business don't have to worry about taking the business back because you have that additional security.

For those of you that want a little more security, you're going to find that over the last years we've developed a program to use real estate, and using real estate as security, you're going to find that you can take the complete security on the sale of the business as the real estate. So, as you leave you get a down payment of X number of dollars. You then have the security on the financing you provide of the real estate don't the street or something that you like. It could be land. It could be an apartment building or a shopping center, and with that you don't have to worry about taking back the business because you have a lien against the real estate down the street which maybe you feel a lot better about. You feel more secure with than maybe the business you're selling.

The first area I want to get us involved in now is a thing called Large Accounts Receivable and Accounts Payable, which is Section One in this LESSON. Now, when you start to think about it, you're going to find many small businesses have a large investment in accounts receivable and accounts payable. Usually the sellers have been advised to keep their accounts payable and receivables. This usually requires the buyer to come up with more cash to make the transaction work. I'm going to take this through this now. I'm going to show you how it does require more cash. I'm also going to show you how to use these techniques to finance business purchases, sales. We also use it to finance part of the working capital we have because one of the reasons that people go through our program and learn the basic types of financing end up doing so well year after year is the financing not only works when you're starting a business or selling it or buying. It also works when you're expanding it, which means you have to understand the basic techniques of financing businesses not only when you're going in or going out, but you also have to know on a continuing basis because if you have to go to the normal sources of financing when you're in business to expand or take care of a problem, you're going to find your payment period is usually very short, the interest rate's very high, and whatever goal you have to accomplish by expanding or solving problems a lot of times the financing you end up getting buries you even further or ends up wiping out the benefits that you're after.

Now, let's start thinking about this now. When you go in and look at a business, first of all, let's think about our Accounts Receivable. When you're in business, what you like to do is receive all cash. The reason we have a thing called Accounts Receivable is a lot of people come along when you're in business and say, "Hey, I'd like you to finance." Again, it could be supplier, vendor, whoever you're working with, but they want you to finance. They don't want to pay you cash. They want to pay you in seven days, 14 days, 30, 60, 90, 180. They want to pay you back in a year. So, you end up with a thing called Accounts Receivable. So, every month your in business, you receive part of it as cash, and if you're in the financing business, whether you realize it or not when you have accounts receivable, you are. So, what happens is you end up with a lot of accounts receivable. You're in the financing business, and every time you're in the financing business, it means you're going to have losses. You sold $100,000 worth, $100,000 was credit. You may only collect 90 percent of it. We'll talk about that later.

The next category we talk about a thing called Accounts Payable, and accounts payable means when you are in business that although you have the pressure of somebody coming to you and asking you for credit, a lot of the pressure of the people asking for credit is taken away in business. How does that happen? It doesn't happen with bank loans. It happens because other people in the business that you do business with allow you to pay in seven days, 14 days, 30 days, 60 days. The ideal situation from a standpoint of win-win is to have the payables balance out the receivables that way you're not in the financing business and either is the other party.

The thing you have to keep in mind in this example right here is we have a business that happens to have accounts receivable of $200,000. They have accounts payable of $200,000. So, they sort of balance each other out. They do.

Now, you say, "Gosh, supposing I don't take them over. I'll just take over the other assets or buy the stock of the corporation or whatever." That's fine, but let's analyze this and see what happens if you decide or the seller decides not to sell these to you. First of all, when you take over the thing you have to realize in selling this business if you happen to be the seller, or you're working with the seller is the seller normally has to pay off the accounts payable, and although every one of you says, "Gosh, the business owes $200,000. The owner will have to pay off the $200,000 before I take over the business as a buyer." Well, the thing you have to realize is these things have to be paid off. Well, how do you pay off the $200,000? Oh, simple, we go out and we collect the $200,000 owed to the business. We then paid back the $200,000 that we owe. It doesn't work that way.

The people that you owe money to when they find out you're selling, want to be paid right now. The people that owe you money don't want to pay you for 14 years or never, and they're going to slow down. So, what happens is the average seller, when they decide to keep these usually find that they can't collect the receivable. They then have to go to their own bank account to pay off the payables. They find that irritating, and when they do that, most of the sellers that I run into will not go ahead with the transaction. What they end up doing is saying, "I don't want to sell." They don't tell you the reason. They give you some other reason. "I'm not going to do it – no reason." What happens is you end up not being able to go ahead with the transaction. You don't know what happened to you. The key thing was they couldn't pay off the accounts payable because they couldn't collect the receivables. What is a general Hamel rule and a good rule of the business? No matter whose rule it is, over 90 percent of the time, you're going to find that collecting the receivables or taking over the receivables and payables work. It is one of the greatest types of financing, and in this cassette we take it from many different sides. But, the thing you have to realize is it's one of your largest types of financing whether you're starting a business or you're buying a large one or you're selling. It works very well, or you want to expand. It's a fantastic way to finance companies.

Now, let's look at it from another side. Supposing you take over this business, and there are no receivables, no payables. Why? Because what happened is the owner kept them. The thing you have to realize is accounts receivables means that you have provide a certain amount of credit. What you don't realize is the first month or two that you take over that business, the receivables or going to climb from zero when you start to $200,000. That means $200,000 that you expected in cash is now going to be what? Money owed to you which means it's a loan.

If you had taken over this company, and you had assumed the accounts receivable, the accounts receivable would run about $200,000 that you took over. They would fluctuate during the month. All that would happen is people who owed you from the month before would pay you. You would then grant new credit and at the end of the month, it would still be running $200,000. What would have happened? Part of the money would come in, part of it would go out, but you'd still be staying at the level of $200,000.

When you take over a company and you do not take over the receivables, the thing you have to realize is you are going to have to have extra working capital to cover the amount of accounts receivable that it's going to grow to in the next 30 to 60 days. Why? You need the cash to cover what? The credit you're going to give out, because that $200,000 that becomes credit or accounts receivable to your company is money that you needed to pay bills, and if you don't have that money because you're in the credit business, what you have to do is have what? You have to have cash to cover that. So, you end up with what? An extra requirement for more working capital. What is the easiest thing to do? Whenever possible, assume the receivables and payables.

Let's discuss some of the reasons owners don't let you take them over. Number one, a lot of owners worry about the fact that you can take the receivables, collect on them, and rip them off on the business. Again, what you have to do is reassure them or put up guarantees in some areas so that they don't worry about that.

The other thing is a lot of times in receivables, a lot of them are not collectable, and because the receivables are not collectable, the seller becomes very embarrassed by it especially his best friends probably don't pay him on time. What happens is he protects his ego and also doesn't have to tell you about a problem he has by keeping them, and what you have to do is dig out what the problem is and tell him it's not going to bother you. If there are things that aren't collectable, you just don't want to take them over.

Now, from the buyer's standpoint, you're probably sitting there now worried, "Oh my gosh, if I take over those accounts receivable, how do I know I can collect them?" Well, in this program the complete cassette program that you're listening to and the book you'll be going through, by the time you finish there's two things you're going to realize. Number one – every transaction what we do is we do a thing called aging, and later when you get to the LESSON on balance sheet and you go through a thing called Aging of Accounts Receivable, you're going to find that we will actually lay out all of the money owed to the company while we're buying it or running it and find out who's past due, who isn't paying on time, and what we end up doing then is try to get the seller to keep those. Why do we want the seller to keep them? Because we don't want to take over receivables where we can't collect. Again, there's no fixed rule on it. if you go to the section on balance sheet, we cover that more in detail. So, what you have to do is worry about that area as far as the accountability.

Now, the other thing is when you go to the other LESSON in the book that has to do with making the offer to purchase, what you're going to find is in the offer to purchase and in negotiating, we also have the seller do what? We have the seller guarantee the accounts receivable that are not collectible. We don't normally do it in every case, but if you're really worried about them, what we normally do is build into the contract, and again, when you get the contract you may decide to add that – a little paragraph that states that if the receivables are not collectible, you can then subtract the amount you didn't collect from the next payment to the seller. Does that always work? It works most of the time. Sometimes the seller does get irritated, but if you set it up properly and analyze them and only take over the ones that you know are pretty good, you're not going to run into many problems.

Let's get back to the example now. Let's start talking about this company. If you wanted to take over this company, what we're saying is we have two pieces of information – the accounts receivable $200,000, and the accounts payable $200,000. Now, what we're saying is that if these are not assumed by the buyer, the seller will have a difficult time collecting the receivables to pay off the payables which is one of the problems that we talked about.

So, why don't we go to step two? As we look at step two, let's look at the total picture because what we're saying here is we have receivables and payables, but what I didn't mention yet is what is the price of the business? Well, the owner wants $100,000. The owner wants $100,000. Now, is the owner going to finance? No, the owner wants all cash. Well, if you're putting off all cash, do you really think the seller cares if you have any background? And, do you think seller really cares that you've gone bankrupt because when you pay the seller that $100,000, the seller's going to be gone. For those of you that are worrying about all these hang-ups on why you can't do it, your weak background, what you have to realize is when you put up all cash, nobody really cares. They don't care if you have a job. They don't care about anything, and if you think about it you'll understand why.

Now, as we look at this we find the price is $100,000. If we then buy it for $100,000, we're going to pay the cash at the close of escrow or the closing. What we're looking at is, "Hey, why don't we take over the receivables and payables?" And, if you're looking at step two, you're going to find the price is $100,000. If we then take over the accounts receivable and accounts payable, first of all you're going to find the accounts receivable happen to be a plus. That means they're an asset. It is something that is owed to the company. When you take it over you have a plus factor of $200,000.

Now, offsetting this, the company also owes out $200,000 to suppliers, creditors, vendors things like that which means they owe $200,000. If you take over receivables and payables, what do they basically do? They cancel each other out. The $200,000 of asset that you have is cancelled out by the $200,000 that you're going to owe. So, you take them over. There's no increase in price. Why? It's $100,000 plus $200,000 minus the $200,000 which means the price still comes out to $100,000. Still the bad news is they still want all cash.

Let's look at this now and see how tough it really is. Solution – have the buyer assume the accounts receivable and the accounts payable. The buyer will only assume the good collectable receivables, and the seller will guarantee, again we talked about that, the collectability of all of them.

Now, step one as far as financing it. We have a thing called accounts receivable, and on accounts receivable, does anybody have any idea how much you can borrow on receivables. Well, if you look at the national, again, there are some receivables you can only borrow about 50 percent, but you're going to find on the average in the United States today – we cover it in another LESSON – you're going to find on the average you can borrow about 80 percent of the value of the good accounts receivable, and if we assume that $200,000 receivables are very collectable and are very good receivables, there are factoring companies out there and banks that will actually lend you money against your accounts receivable, 80 percent of them.

Well, if they will lend you 80 percent of the accounts receivable, what are we talking about? We're talking about $160,000, and you'll say, "Well, gosh, how can we do that? How can we get the money?" Well, first of all, if you're borrowing money against receivables, all you have to do is have access to them which you can get in writing the contract. You take them to these people just before you take over the business. They will then look at which ones they want to finance, and at the close at that exact moment it closes, they will take the security of the receivables and pull them out of that little pot – the escrow or closing pot – and replace it with $160,000. You putting up the $200,000 as security on $160,000 loan.

Now, keep in mind, you can borrow on accounts receivable even if you're companies going bankrupt. It could be a start-up or IRS could be nailing the door shut. Why? Because the ability to borrow on receivables has nothing to do with the company you own. It has to do with how collectable are they. And if they are very collectable, you're going to find it's very easy to borrow against them, or later on in the program you're going to find you can sell them.

Now, if you have $160,000 now, which will be available to you on or before you take over, how much money do you need to buy the company? You need $100,000. Big deal. You're always telling me about how tough it is to finance. This gives you an opportunity to buy a business for $100,000 price. You can finance the receivables which is in most companies today, and you can usually borrow more than you need to buy the whole company if you wanted to go that way.

Now, incidentally that gives you $100,000. What do you do with the other $60,000? I like to say in our seminars that you send it to the Hamel Foundation. There's no such thing. Again, you can use it for additional working capital or whatever else you need it for in the business. We, most of the times in our company, we don't pull the money out especially in the beginning because you could never tell what's going to go wrong. Extra money always comes in handy.

So, what we talked about is financing the accounts receivable. Now, suppose in financing the accounts receivable the people financing it will not do it before the close.

Well, why don't you set a deal up? We're going to pay the seller a dollar going in, and we then owe the seller $30-$40,000 or $100,000. Why not pay it within ten days or 15 days after you take over? You're going to say, "Well, you can't do that." I hate to tell you this, I work on hundreds of transactions every week, and I see it happening a number of times every week. All you have to do is ask, and if you're providing everything else, and you just want a little time a few days, I find very few sellers that I run into that really care. What you're going to do then is you're going to use the receivables to finance the down payment or finance some other thing you're doing. It's not really a big step as long as you the buyer get over the fear of doing this.

Now, let's take the next area, and again, we talked about financing receivables. That's an asset. So, you finance assets. Now, we're going to take you in the area of financing debt. You'll say, "That can't be done. How can you finance something you owe?" Well, as I take you through this, what you're going to say to yourself is, "Nothing can be better than financing receivables." Let me tell you something here and now, payables give you even more money than receivables.

Now, let me take you through this, and again, we're only taking it from one side. As you start to get out in the real world of business and just start to consider what we have in this section on receivables and payables, you're going to find that you can add things to it and change the technique a little, and use these two areas to do all sorts of things in business from start to buying, selling, expanding. What you have to do is just open your mind a little. Not be creative, just look at it, see what your problem is, and see how you can use these two items to solve your problem, and it does solve a lot of problems you're going to find out.

In fact, let me tell you something, this area of financing works so well, that I see a lot of business owners get in trouble because the money comes very easy in this area. The paying it back or the interruption of the cash flow is the thing that ends up goofing you up. So, the problem here isn't difficulty. The problem is what you end up causing problems in your company because it is so easy.

Let's look at the accounts payable now. In our seminars, what we always do at this time is always ask the group, "How many people here work for large companies or small companies?" They raise their hand. I say, "Okay, and the companies you work for, have you ever worked for a company or been with a company or owned a company that paid or had people paid them other than cash? Maybe pay in seven days, 20, 30." A lot of people say, "Yeah, 30." They raise their hands. Then, I say, "Have you ever worked with a company or been involved with a company where they pay in 60?" I'll still get a large number of hands. "90?" I have a large number of hands. So, there's a lot of companies out there that are normally paying with approval in 90 days.

You're also going to find a lot of them pay in 120 days, 180 days. When I'm in certain parts of the United States, three-quarters of the hands are still up at six months. If you get involved in a sporting goods business where you're dealing with the government, you're going to need nine months credit because the government doesn't pay much faster than that. In the toy business, it's usually a payment once a year. You're billed the first of December; you pay the first of January or something like that.

So, you're going to find everybody in this country has a feeling that there's only two systems involved. In fact, if you don't believe this, go out and talk to business owners later. Half the business owners will tell you – well, not exactly half – "I always pay all cash. The only reason I pay all cash is if I have 30 day credit, it destroys my credit. So, I always pay all cash." The other group of business owners are going to tell, "Hey, I pay it in 30 days. Anybody that pays in cash is stupid."

What you're going to find is both groups of people are really stupid because what you should be doing is working other people's money, and when you start to have this feeling that you have to pay it all in cash, and I understand that, what you're finding is you have to put more money in the business because you are not using the standard facilities available, and avenues open in business to get financing. You're going to find this financing doesn't cost you any money, and since there isn't any interest in a lot of cases there is no repayment as long as you do business with them, we all think you're crazy enough to do that.

Now, keep in mind, as I take you through different techniques like this, we call it, "The Going to the Well" principle. There's a thing in business which we discuss in another LESSON of these tapes that's called Inner Business Financing. One business lending money to another. It could be receivables, payables, actual cash, which I'll talk about in another LESSON, but the key thing you have to keep in mind when you start to go out in this area the number one financing that we run into all over this planet – planet Earth – is interbusiness financing. Again, you can say banks, the SBA, they're very nice people, but they don't provide much money for us in business. It's a very small, small percentage.

So, what we do is we go to these other sources. These other sources is the way that most of us that are very successful in business do it everyday. We have been doing it for years.

Let's look at the accounts payable now. Now if you look at the next page here, what I've done is laid out the accounts payable. It's laid out for a six month period, and what it says basically people are supplying you with goods. In month one it said, "$200,000 in goods are delivered to you" Again, they're going to be called accounts payable that are delivered to you during the month you are billed. You pay 30 days later.

In month two, you're going to find that $200,000 worth of goods are delivered to you. You order them. They're delivered to you. You're billed in a certain period of time – 15 or 30 days. You then pay in this certain period of time.

Normally all of these are 30 day pay periods, and we run into a lot of companies that normally pay in 30 days. Now, suppose you want to pick up some money. Let me show you what we normally do. You're going to find out later in the program we actually go out to these people to try to borrow money, and we'll talk about that in another section, but right now let's just talk about this.

Suppose when you take over a company, they're normally paying in 30 days. Just think about this mathematically – not complex math – and look at it. At the end of the 30 day period, we owe $200,000. Since we've sold those goods, maybe for $3 or $400,000, we take $200,000 of what we took in selling those goods, and we pay the people the $200,000.

Now, supposing instead of paying on the average of 30 days, and again when I say the average of 30 days, I mean some people are going to require you pay all cash. Other people are going to be paying in seven days, 14 days, 30. What does the average mean? It means you also have a couple with 60 and 90 days, and if you take the average of everybody that pays, it comes up to what? To about 30.

What you have to realize is and what you're going to find out later in the program, is how do you move these out a few days? How do you move the 30 day average pay out to 40 days or 50 or 60? And, also what are the results if you move this out? Once you understand this concept, you're going to find it solves a lot of problems in business as far as financing, and if you don't start to follow it, remember, whoever's at the end of the line doesn't follow these techniques in their business financing, goes to the well. What does that mean? It means eight of us do this with other company. The other person at the end of line that doesn't know these techniques or won't try them, has to do what to get their money? If somebody has to pump money into the system, they end up going to the bank. So, eight of us are getting the benefit and not paying interest on money. The one at the end of the line aside because they don't know what they're done, they have to go to the bank or go to a lending institution. When they do this, again, they usually don't survive. Why? Because what's happening is we're milking out their profit, and what you have to do is number one learn these systems, number two use them immediately and when you're talking about receivables and payables at least get to the point where they balance each other out. The reason they balance each themselves out in a lot of companies across the United States is survival. It just ends up happening because the owner of the business realizes as they give out more credit, they don't have the money to pay. So, the accounts payable, the money have to rise the same time they're giving out financing. It's just the only way they'll go. They don't have the other money.

Now, as you think about this, supposing we could show this up to 60 days. Instead of paying at the average at the end of 30 days you can pay at the average of 60. Well, if you can do that I want to ask you a question, how much do you have to pay on the average after 30? Now, remember we're not just getting a one-shot deal. We're not just going to pay at the end of 60 one shot, and then we're going to go back to 30. This is going to be on an ongoing basis. Suppose we can pay at the end of 60. How much supplier money do we pick up? You're going to find in month one, if you're always paying at the end of 60 days when you first take over – this doesn't happen all the time. It just happens on time. How much supplier money will you pick up? $200,000.

Supposing on the other hand, you're able to take the accounts payable and move them out to 90 days, and if you're moving them out to 90 days how much supplier goods have you received and how much do you owe? You owe $400,000 for the first two months. But, since you're paying 90 days late have you not already taken most of those goods and already sold them? Yes. Don't you have the supplier money sitting there that you should pay them? Yes. If you're paying in 90 days if you just look at your sheet, those first two numbers there the $200,000 and the $200,000 are sitting in your bank account. Does that mean you don't owe it to anybody? No, you do. If you look at your balance sheet, you're going to find that the balance sheet, if you haven't paid and you pay at the end of 90 days, you're going to find there's going to be $400,000 extra cash sitting there. You're going to say, "Well, don't I have to pay it someday?" Well, let's look it this way. It's going to be offset on the balance sheet by having additional accounts payable.

You also then can take this $400,000 or whatever the amount happens to be, and do what? Use it for working capital. Does this working capital cost you interest? No, it doesn't because this happens to be an accounts payable account, and as long as you're paying on time, what do people do? People do not charge you interest on it. It's only when you pay it late.

For those of you worrying, “Well, gosh, it could go out to 60 or 90 days, aren’t we going to have to pay interest. Aren’t we going to lose credit?” No, you’re not. If you are entitled – these are large companies now – if you are entitled to a discount by paying on time in 30 days, once the payment period moves out to 90, if you pay on time, do you realize you’re entitled to the same discount? You better watch that because sometimes you’re going to be on the other side.

Now, suppose an example, let’s go out a little further. Suppose we could move you out four months, and if you want to talk to your friends in business in the next couple of days, talk to them, and you’re going to find a lot of them are beyond 30 days today. I’m not talking about they’re doing arbitrarily because they can’t the bill. They have permission to pay in 60, 90, or 120 days.

In 120 days, the amount is $600,000, but let’s really be gross right now. Let’s move all the way out to six months. You can move it out to six months. We have a large percentage of people that do that. I don’t mean 50 percent, probably 10-20 percent that moves it out to six months eventually. It takes a while. But, once you do that, and you’re paying all these in six months, you’re going to have five months of suppliers’ money sitting there. Five times the $200,000, it comes to what? A million. Do you realize you have a million dollars sitting in the company now?

Do you want to do something really gross? We did this on a company in this example, which is a standard that we run into all the time that only has a price of what? A hundred thousand. It probably only makes $20-$25,000 a year. It’s not even a Mom and Pop. It’s a crummy business, but on this business that you’re looking at in this example which is very small, the next $20-$25,000 you could set it up, extend your payables, and end up with a million dollars of supplier money in your bank account. You still owe it, but could you put that in certificates of deposit and other money market accounts, and receive a return if it’s ten percent right now. Ten percent of a million dollars is $100,000 a year. I mean, realize on this one technique you could make $100,000 a year, $90,000 a year on a business that the rest of the year only makes $25,000.

For those of you of little faith that like to read Forbes Magazine and the Wall Street Journal – I don’t know exactly how often they run articles on things like this, but I’m sure if you’ve read those magazines or periodicals, you’re going to find that if you go every week or two and read all the articles, within a week or two there’s at least one article in there that has to do with this. You just never understood it.

It is a program. It is a method used continually all over the world by a lot of different companies, and if you don’t understand the technique and you don’t go out and use, I hate to tell you this, you’re cutting down the profit margin and the cash flow tremendously which makes it more difficult to run your company, which means the thing really doesn’t make sense, and what you should consider doing as we take you through these things is go out and try them. If you now sit there listening to this tape and get a feeling that this doesn’t work, and you are not going to try it, you would be absolutely right. If you then go out and try it, keep in mind one thing – there is nothing that we teach that works everytime, but within our financing area – this LESSON and the other LESSON we cover financing – I don’t care what you’re doing. If it makes even medium sense, you’re going to find there’s more than enough financing techniques to put together your start-up, your sale, your expansion, or the purchase of the business.

So, again, let me restate. You have to go out and try them. If you're at the point right now that you don't believe this, what I suggest you do is start the tape all over again and keep listening to it. The purpose of this tape is to motivate you, is to educate you, is to reassure you, and I hate to say this – if you listen to each tape enough times – to brainwash you. How do I know that? The tapes were set up that way. The program was set up that way, and based on our follow-up it does work that way. So, if you don't believe it the first time through, keep listening to it, and by the third or fourth time, you may not be able to stand my voice, but you'll be able to go out and try it and you'll actually believe it, and guess what? It will work.

The next section which is section two, is really the introduction for the last two parts of this LESSON, and we're going to be talking about the financial statement and the real estate joint venture. In other words, people putting up their financial statement as a guarantee or real estate as a guarantee, or joint venturing with you.

Before we get into the meat of each section, what I'd like to do is spell out the general rules of the real world, and if you really listen and watch and understand the next few pages, you're going to find that you're not going to have trouble in this area. What happens is those of you that have the most trouble in this area are the ones that don't listen. If you still don't get it, just listen to it a number of times.

First of all, example one, you're starting a business, you only have an idea. You have no business plan. You're buying a business. You haven't found it yet. You haven't negotiated it. You don't have a contract. You really haven't done anything. Well, let me tell you what the rule of thumb is and again, I don't like rules of thumb, but you should understand these so you can understand whether you're working with us or whether you're doing it one, what you have to realize is how the world really operates, and there is no free lunch.

First of all, the rule of thumb – a financial statement or real estate joint venture partner would keep 90-100 percent of the project, but why? Because you haven't done anything. You end up buying a job. You have a chance to buy back maybe ten percent with cash and effort, or maybe you'll be given ten percent of the project. This happens quite often on these projects with venture capitalists because basically on here we're going to be talking about venture capitalists that don't end up wanting all this time 90-100 percent of the company.

So, again, if you're starting a business and you haven't really done anything or if you're buying on and you haven't done anything. You're not bringing anything to the table. The thing you have to realize if we were to put you together with somebody, or you do meet somebody say in this area that has the real estate or the financial statement, I might as well flat out tell you, you're not going to be satisfied. But, again, I want you to look in the mirror and say – if you had the statement or you had the real estate, why would you give up more than this? Because you're asking for a free lunch.

You're asking for somebody to come out and do everything for you, to provide everything, and you want all the benefit. Why? Why would anybody ever do that? Will they? No. I'm sure if you went to your mommy and daddy, they wouldn't do it that way. So, what you have to do is welcome yourself to the real world.

The next thing I want to cover in this area because it's only two basic approaches. Again, have you done anything or haven't you?

Example two, next page – you're starting a business. You have a detailed business plan. Again, you've done something. You've put together the business plan. You're expanding your business and you have a detailed plan, on repaying the loan and the safety factor. You're buying a business which is another approach. You successfully negotiated the purchase. The offer's been accepted. You've done a lot of work on it. You're bringing something to the table.

What's the rule of thumb? There's a fairness doctrine that everybody uses out there. We don't talk about. This is the way the thing really comes down. This is the way people negotiate. This is how the transaction turns out. The less the risk, the more you keep. The more you bring to the table, the larger your percentage.

If you want to go out and put together a transaction and have somebody come in and give them a very small percentage of it, and then have a chance later of buying them back out, you could do it. As long as you've done what? As long as you've done everything up to a point. You have to follow the system.

Some of you go out, and you can't make certain things work, and you start to whine. Let's just end up this thing by saying one thing. The question – at the bottom of the page – which would you rather have? And, think about this. Would you rather own a business netting $50,000 and own every piece of it? Or would you rather own a business netting a million dollars and own 80 percent with an option to buy back the other 20 percent? Because the people that put up the statements and real estate, don't want to stay with you. They want you to buy them back in three to five years.

When I get to the section later that has to do with limited partnerships, you're going to find you can set up a limited partnership so that they are sold, and buy law they can't say anything which means that you own most of it. You don't have anybody interfering, and you have a chance to buy back it, and it enables you not to start at the top, but you're going to start off a lot higher than you normally would and it works out very well.

When we start to get into the area of financial statement rental, a lot of people think of it as a Mickey Mouse thing. You have to realize one thing. We just don't arbitrarily going into people, and say, "Okay, we have somebody with a million dollar statement, five million dollar and ten million dollar." Although you can allude to it. We tell them the fact that as soon as we have certain information, we then will put you or you sit down with somebody else that basically is going to put up their financial statement. You then sign an Intent to Joint Venture or Joint Venture Agreement at that time.

But, before we get into this, let's talk about the basics of this thing, go back to the program. Although we've been telling people that we've been doing this for the last two and a half, three years, when we started two and a half years ago, basically this thing goes back a lot further. We've been doing it on sort of a formal basis for the last two and a half, three years. Before that probably for about ten or 15 years, 20 years before that. We've used the two different approaches we're about to go through, a number of times. I have a lot of people in business and friends of mine in the real estate business also that use this technique in various forms. In fact, I'm sure it goes back thousands of years. There's nothing magic to it. The comment I have to make is I wish we had come up with this program about 20 or 30 years ago. It would've made it a heck of a lot easier for a lot of us.

This program we're about to go through now in this section and the next section works so well, that what you're going to find is it's giving us a second and third level type problem today. The problem really is these two programs work so well, that now we have a situation where people that are basically really not qualified are buying companies that are a little too large for them, and because of this situation, we're having to work with people around the country now on providing more consulting help and more management help, and in some areas just having a company go in to run the business for these people because they're not far enough along to run something that large. Again, it's just a new situation. The basic program does work just like a lot of other programs, sometimes it works a little too well.

About two and a half years ago when we first started getting involved in this program, we realized one thing. Everybody wants to have a million dollar net worth. I want to reassure you, when you don't have the million dollar net worth and you're reaching for it, that's great. Many of you listening in the next few years will have a million dollar net worth if you don't have one already.

The thing that's fascinating, right now you're probably fantasizing what it's like to have a million dollar net worth. Well, if you go out and follow what we say, you're going to have that million dollar net worth, but on the other side you're going to find that by the time you get to the point where you have that million dollar net worth, it's not going to be that rosy. Why? Your goals and your sights will be a lot higher, and by that time, you'll probably need a five to ten million dollar net worth, which means you always really need somebody because as long as you're progressing and growing, you're going to find as you grow and become wealthier and have more substance, you're working on a project where it requires even a little more than you have.

Although you are wealthy, you are substantial, you need a little more. Again, if you do much reading, you know that this happens to everybody. There's nobody out there that can just stand on there own. I mean very few people on each project. So, what they need to do is bring in other people as solemn as possible because they don't want to have a lot of interference.

So, keep in mind, you're always going to need something like this, and also don't be afraid to use it.

Now, the warning on the other side is as you go through this, these things cost money. They cost ownership. Maybe you don't want to give up ownership. That's fine, but the key thing to keep in mind is these things also cost money. Now, if you're doing it with mom and dad and things like that, you know they're not going to charge you. But, whether they're charging a fee, a piece of the company, whatever, there's a cost in this area. So, keep in mind, you don't have to use it all the time.

In November of 1984, we finally announced this program on a national basis. We had played around with it for a couple of years. We had started working on financial statements about $200-$250,000 and above, and also real estate with equities of a million dollars and above, and at that time, although it seemed like a good place to start, it wasn't because what happened was although we worked with a lot of nice people in these different areas for a couple of years, we find the small ones had a hard time making them work because we then would have a person with not that much in the way of assets or equity working with another person in business, and what would happen is each one of them would want 90 percent of what we were doing, and what would happen is it didn't make any sense. We didn't have 180 percent available.

So, what happened is we started gravitating. I don't want to kid you. We probably quit the program every hour for the first couple of years. I mean I was never so discouraged. It looked so good. It look so simple. Couldn't make it work.

Finally, about August – July or August 1984, we decided to move up to a million. We had been working on larger business and real estate, so I decided that we pay the million, and son of a gun, as soon as we pay the million on the guarantees and the financial statements, it started to work. The numbers started to make sense. We had more security.

As you go through this, you're going to find this is a win-win situation. Everybody wins. Now, the difficult thing is that in the last few months to a year, I've been out presenting this all over the country to different groups on television, radio and in person – is it is so simple that everybody has a hard time comprehending it, and the reason for it is even the simple things in your life are a little complicated, and because of that, you have a tendency to take the things that are really simple and try to build something into them.

I can still remember the first real estate group I talked – top real estate marketers, exchangers, commercial industrial people in the country, a few hundred of them – and when I talked to them, they sort of sat there and looked at me over with glassy eyes. I went for questions, and we never got down to any questions on it.

True story – two weeks later, I finally got a call from one of them, and they said, "I finally figured out what you're saying." Now, as a person that's been educating people and thinks most of the time he speaks fairly clearly, it was really frustrating. Why? Because I couldn't figure out how could I put across something this simple? I'm going to attempt now also, but keep in mind, do not try to build problems in because you're going to say, "This sounds like a stupid question." There is no stupid question. There is no stupid thought, but keep in mind, this is the original KISS formula, Keep It Simple Stupid. This is simple.

Now, let's start talking about the area. It's not uncommon for business brokers, merger and acquisition firms and sellers to want to see a buyer's financial statement. This is perhaps one of the stickiest problems many of our graduates face when they go out to buy a business. A person can have all the attributes and motivation it takes to run a successful business or start one, but may lack an impressive financial statement.

If you're been a working person for most of your adult life, working for someone else, it's doubtful that your financial statement or your net worth and borrowing ability would impress anybody or very many people. You know that you intend to creatively finance a purchase of the business, but you often don't wish to disclose the information early in the transaction. The answer is to involve another person in your buying team- a person who has a strong financial statement, and later on a person who has a lot of real estate equity. It opens up a lot of doors, but the key thing is with a real estate financial statement it opens up the door. It opens up a lot of doors, and the reason we start with a million dollars is it doesn't cost much more to rent or bring in someone with a million dollar statement. They are easier to work with, and as soon as you say a million dollars to somebody that's selling or whatever, it opens up the door. I mean they really feel good.

They want to know that between you – and again, look at yourself. You may have gone bankrupt 15 times this year. You may be a convicted felon. You have to realize between yourself and the other party, you look triple A.

Incidentally, even if you get into the business, and you don't have good statement, keep in mind that when you get into that good business, what do you have? You have yourself with all the problems and background and crummy financial rating that you have. And, what do you tie in with them as you get the business? You have a good business that is triple A.

Whether you're going in with somebody with a statement or later on you get in by yourself, that business is going to make you a triple A person, and it's going to basically drag you along with it.

The other thing I keep telling you – every one of you love to come to me and say, "Gosh, I don't have any money. I can't get into business." I keep saying to you, "I have that place on my wall in my office in San Jose reserved for the picture of the first business owner that used money going into business." I don't know anybody. I'm sure there are people out there, but I don't know anybody that started with money. That's why we go into business. I think if I wanted to buy something and had a lot of money, I'd go out and buy real estate, tax shelter, things like that.

In business, we do it for one reason – cash flow. What you're going to find, as we talk many times, if the business has enough money to make the payments safely and have money left over, financing it 100 percent is not difficult. It's not magic, and as you know if you've gone through much of this, you have a lot of money left over. There's nothing magic to it.

What does a financial statement do? It opens up the door.

When you're going out to start a business from scratch, or you're buying a Mom and Pop, the people are looking for a financial statement that has cash flow because when you're starting a business or buying a Mom and Pop, there's a lot of times not enough money to pay the debt. So, the people are looking for the statement for what? For cash flow so you can pay debt.

When you start to get over $50-$100,000 profit businesses, you're going to find most people are asking for a financial statement because they want to find out where the down payment's coming from. Do you have the money for working capital? That's what they're looking for.

The business already makes a ton of money. They're not worried about the repayment of the debt. What they're worried about is what? In most cases, the down payment. So, they're looking for a basic thing.

I also want you to realize right now, and I want you to listen to this over and over again. When you work on businesses that make over $50 and $100,000, very few of them need financial statements, very few of them need real estate guarantees.

October 1984 when we first started to announce this program, during that period we had many people calling us continually that needed help that didn't have a financial statement, didn't have a real estate guarantee. Do you know what happened to all the calls we had as follow-up in our seminars after we told people it was available and reassured them and showed them definite proof? They quit calling. Why? Because once you know it's there, I hate to tell you this, you're not going to need.

So, what I want you to do before you go out and do anything, I want you to listen to this over and over and over again until you find out how ridiculously simple it is and how easy it is to get this, and what the benefits are. When you go out and you get into a situation where you need either a financial statement or real estate, you're not going to bat an eye. You've got it or you can get it. You don't have to worry about it as long as what you're doing makes sense and you're willing to give up whatever's required.

One of our students called the office recently, and again we get a lot of things like this, "Art said in the seminar getting a financial statement is easy." Well, those aren't my words. Here's what I really tell you in seminars. I'm going to tell you right now. If you don't have a good enough financial statement, go through a business broker, a merger and acquisition firm. Before you get involved in a business, I suggest you find somebody go in with you.

Now, of all the other types outside these three areas, you basically don't need that, but if you do have that problem instead of fighting it, why don't you find somebody with a financial statement? Why keep fighting the problem? Are they out there? Yes. If you have something that makes sense are they difficult? No, they're not.

Incidentally, once you do that and have a financial statement, the doors open, and it's easy, and again I say easy here. I don't like to say easy. That's a basic mistake. It's easier.

Over the years in business, the reason we have so many people that succeed is we have simplified the area of business. Many people then think that we're saying it's easy, easy. There are areas that are easy, but the overall business transaction is a difficult one.

Now, is it easier than it used to be? Yes. Is it simple today? Yes. And, with that, can you do it? Yes. The only bad thing is you have to maybe leave television for a while.

Now, again, putting together a financial statement's not easy. It's simple. Again, that's what I just said. After you get the statement, the rest of the effort is relatively easy. Why? Because a lot of you have mental hang-ups in this area. Once this is provided, once you have it, or once you know it's there, what happens is your whole attitude changes, and what happens Is you go out and put together transactions and do things in business you wouldn't normally do. Why? It lifts you up a little. Is it available? Yes. Is it real? Oh, is it ever.

Ever since we started doing it, I hate to tell you t his, we've always had more people come to us with financial statements then we've had those of you come back to us that needed them. So, we actually have more supply than we have demand.

The next page now, and let's look at the financial statement, joint venture, possible uses. Why would people want this? Number one, borrowing power – you're starting a business, and when you start a business, it gives you more borrowing power. You get a better rate. You get loans you couldn't normally get. You're going to find your borrowing power expanding in business. You can get a better loan, a better interest rate. In a lot of areas, you can get loans you couldn't normally get. Why? Well, let's face it, if you put enough security or enough strength for a bank or a lending institution, even if your project didn't make sense, they'd lend you the money. That isn't good news. I'd rather only have you borrow on things that make sense.

Borrowing power – how about buying the business. It opens the door when you have this financial statement. You get better terms. The people love you more. Why?

Because between you and the joint venture partner, you're on a cloud. You're a group that has a million dollar net worth, and that opens up the doors.

Borrowing power – again, we're just talking about borrowing money now. I don't care what you're trying to do. Once you have that financial statement whatever the number happens to be, one million, five million, ten million – again, we can talk about numbers all the way up. We worked in the last year up to numbers about 30 million. At one time we had three people under contract with over 30 million dollars in net worth. They'll let you go on anything. That was not too risky because they still are not looking for great risk.

Let's continue on now, and the next page we have a thing called categories and let's go through this. I'm going to take you step-by-step. Why do you use it – now, let's talk about when the person's putting up the financial statement, if you're this person with this statement or you're the person putting up the statement, what kind of risk is involved, what kind of payment? We're going to take you through that now.

First of all, a joint venture partner provides the financial statement. In other words, you're buying the business, expanding or whatever, and there are no guarantees. You'll say, "What do you mean no guarantees?" Well, the thing you have to realize on most larger business, over 50 percent of them, I don't know what the exact number is, you're going to find that the business stands on it's own two feet.

The financial statement basically opens the door. Once it opens the door, you're going to find many business owners do not ask for additional security other than the business. They don't ask for personal guarantees of the financial statement. They just want to make sure they're working with somebody that can succeed so they don't have to take that business back. They want to feel good about that person or that group that they have before them.

Now, if you think that the provider of the document need only put up his statement to open the doors, you're missing a point. Done that way, and again, you're committing fraud. What I'm saying here is just don't say you have somebody. Don't have somebody and have them committed to writing. Okay? Because unless you have something like this you're committing fraud because you can say, "Okay, I have somebody with ten million." "I have somebody with 50 million." And, over the years, where we've talked about programs where somebody rents a financial statement, or sets up a joint venture, they don't do it writing. You do not have to do anything Mickey Mouse in any business transaction. I try to tell you that over and over again.

You can make more money honestly than you can dishonestly. If you're getting to the point where you think you're going to have to become dishonest, I suggest you get back with us, and we'll show you an easier way to do it. You can make more honestly. If you want to do something creative, go skydiving, buy a racing car, and don't commit fraud.

You should go with a declared intent to set up a joint venture with a statement provided. In other words, a person's going to provide a statement, set up a letter of intent in writing or set up the complete joint venture agreement. Again, a lot of times we set up a letter of intent because we're not exactly sure what the final form is going to take.

When you get down to the end and are approaching the purchase neither of you are still tied down except as to term if you do find something. When you get down to that final point, and you have found the exact business, you can then sit down with an attorney and draw up that long form document that spells out the details of your joint formal agreement.

Your letter of intent just spells out if you find something what is the ownership going to be, what kind of guarantees does each provide, what does A do, what does B do in the transaction. You can then notify the agent, broker in the transaction, the seller of the event that we're now about to go. Again, the thing to do is full disclose. You don't have to lie to people. What you're going to find is you can tell them truth, and in this you're not hiding anything. Just tell them what the progress is. Let them meet the other party, and you're going to find the transactions then will just slide right through.

Incidentally, the last thing here is proceeding together is certainly a favorable action because you can accomplish or expand faster and agree to later buyout, and also, if you then go in at the beginning with a person with a larger financial statement than possibly you need, you don't have to go back to another person. You can go back to that same person or group and have them go through a number of transactions with you because once you show them how they can win in the first transaction and not take a great risk and get a fantastic return on their investment which a lot of times is just time, it could be a guarantee, you're going to find they're going to come back and see over and over again, and they're also going to send a lot of other people to you because success breeds success.

Now, the second category on the next page is the joint venture partner now is going to provide a financial statement. Now, in category one, we had on the other page, the person wasn't guaranteeing anything, basically just opening the door. You're now going to find that the joint venture partner here is going to guarantee something.

Now, one thing I forgot to mention in section one that we might go back to is in section one, we mentioned no guarantee. Supposing the person comes to you and says, "Hey, I'll put my statement up. I want a certain amount, but I don't really want to guarantee. I'll go in with you, but guarantees scare me." Well, what you can do is a two-step transaction. Have a person go in with you under contract with a financial statement say you're joint venturists, and when you get in there and the guarantee comes up, you can go to the next section which is the real estate guarantee. In other words, the statement opens up the door, the real estate provides the guarantee. There's nothing wrong with that except for one thing. these things are costly. So, keep that in mind as you do this. In other words, make sure you still have enough cash flow left in doing all these things.

Now, the next category – the joint venture partner is actually putting up and guaranteeing a minimum area, he or she is guaranteeing equipment. They're guaranteeing inventory or receivables. The thing in this area is there's not as much as risk as a complete guarantee because you have an asset as a guarantee. You can pull back and sell that asset if you had. You can place a lien on it in the state. So, there's less risk in this inventory than a complete guarantee area.

Now, the joint venture partner then will provide the financial statement, again, the next category a total guarantee. So, we started with no guarantee, and they're going to get paid a certain amount as you're going to find out in the next few minutes. The next category is there's a minimum guarantee, and then the third category where we have fewer people basically is a joint venture partner provides the financial statement and they're going to total guarantee.

Now, keep in mind, sometimes people will start in category one or two, and then after you show them they're not going to get hurt, they'll move to category three. Or, maybe they'll do it on the next transaction you work on. Be patient. There are more people out there that will do than you actually need. So, make sure you do it with quality type business ventures.

Now, in this one here, there's 100 percent guarantee, and the thing we don't really talk about that much is that if you have a person that has a strong enough financial statement, and although we continually tell you that you're going to next "X" percent down – 10, 20, 30 percent – as a down payment when you buy the business or start it or expand it, you still need money, the thing you have to realize is once you have enough strength in either real estate guarantee or a financial statement, and I hate to bring this up at this time, we end up a lot of times end up financing them 100 percent because the down payment was basically tokenism. If you're willing to put up something as a guarantee, many sellers are going to tell you that the down payment isn't required which means you do end up getting it with nothing down to the seller. It doesn't happen often, when you do work with these it happens more often than any other way of doing it.

Now, when we look at the next page it says, "Obviously both parties, the one needing the financial statement and the one providing it will want detailed information about the other. The financial statement and guarantee will have to be verified." We verify these. You verify them, and the person wanting them will have to meet particular standards of capability. "The degree of involvement of the provider and his compensation whether it's a fee or a piece of the business will be negotiable." The things we're about to talk about now which have to do with fees are negotiable. They can go up. They can go down. All we did is set this up as a standard a number of years ago so we had a place to start, and we move down. We move up.

What we do then, what you should consider doing is don't fight the problem. Since there are so many people out there that will provide these or need these, find somebody that's pretty close to what your demand is whether you're putting up the statement or needing it, and that way you don't have to go through negotiation. You have a pretty close fit, and again then it gets down to the point between the two parties of the joint venture is more or less, "Do we like each other?" "Do we want to work together?" "Do we trust each other?" And, that makes it easier. You shouldn't have to sell these things. They should just fit.

Now, if the person needing the financial statement does not have a strong enough management skills to satisfy the provider, you can arrange interim financing in that area until the person's skills reach the level. It may never reach the level. They may have to have support forever, but again, we can have consulting firms. There's all sorts of consulting firms all over the country that provide help. In other words, they will go in and crutch that person on a continuing basis or a part time basis.

There are management firms that will manage it completely. In other words, you can go to part-time help, full-time help, or not even help where they do the complete thing, and basically it's like a management company in real estate. They mail you the check, and there's a number of good companies around.

We hope it's apparent at this point that we're striving for a situation with everybody – the buyer, the statement provider, and the seller – wins. To paraphrase, we want a win-win-win situation. If you're working with a lender, we want them to win also.

If the financing is dangerous, don't burn the people. Anybody, what we want you to do is use another type financing. What we like to do is keep this clean. We like to keep this to the point where people can go into it and they know if the business is good and makes sense, they are not going to lose anything. We have to keep the risks down. In fact, what we're shooting for is no failures. We haven't had any yet, and all I'll tell you something, if we even sense a little problem, personally, we won't even touch it. We don't want anybody to get burned.

The cost of the financial statement – the financial statement now, we're talking about a million dollar net worth. Above this, the figures climb accordingly. If you're going out on your own, you want to find a smaller financial statement. I say fine. We aren't working anything below that because we find below a million, we don't do a very good job.

Let's take the three categories. Category one – we normally offer somewhere between $10-$30,000. It's a rule of thumb. Again, you may have to pay less or more, but let's face it. If you have a million dollar net worth, and you want somebody to put a statement and even answer the phone, if you don't offer them $10,000, they're not even going to be interested. Now, do you have to pay them in front? No, we usually pay them at the close of the transaction. Will they finance it? Of course they will because basically if they're not putting up a guarantee, you're paying them a heck of a lot of money for a little use of their time. In fact, we have people now coming to us that would like to specialize no guarantee, because they can put their statement up continually. We're not interested in that for other type reasons.

Category two – we're offering $10-$30,000 cash. Again, this is financable. All of this is financable. It's also flexible. You can offer less or more. Again, you're going to find unless you start off with about ten, most people don't turn on. We also find with this smaller percentage, we're offering a piece of the company, five to ten percent. I've had some at two or three percent. I've had others that want 14 or 15. Again, the average range is somewhere between five and ten percent as a rule of thumb. Again, the key thing is to put the transaction together, and if you're off a percent or two what difference does it make if whatever side you're on you end up getting the benefits you get and it doesn't endanger the transaction. Quit nit-picking.

Category three – in category three when we're talking about guarantee of almost the total company or the total company or the transaction you're going into, the owner's going to want probably at least 25 percent of the company or you're not going to get their attention. That may vary as you get into larger areas, but the ones we're talking about, it's normally about 25 percent and up.

It could be 51 percent and above if you don't do your job because if you haven't done anything and you haven't brought anything to the table, and you're asking them to guarantee the whole thing, why do they need you? In fact, I'm going to tell you something, I wouldn't give you a nickel for it. I may pay you a finder's fee and send you off somewhere. I might give you a management job. But, if you're intent is to own the business, then bring something to the table. Show them what your worth is. If you don't do that, you're going to come back to me crying and say, "It can't work." It does work. What you have to do is realize what the real world is and do it that way or you're going to find out that you have problems.

How do you find a financial statement? My gosh, I want a financial statement, but I can never find one. It seems impossible. Well, one of the easiest ways to find it is family, friends and relatives. If you turn the page, this is the easiest way. It's the cheapest way. It's the best way. Especially, if you have a member of your family that has a good statement and your goal is to open up doors. If you then go in with them, and they're not putting up a guarantee, what member of your family wouldn't do it? I mean, what are they losing? They're helping a member of the family. You can either compensate them or not compensate them, but it's the easiest way to go. Tell them what you need, what you'll give up, quit being so chincy, give up part of it. You'll end up with a lot more.

Also, get these other people to birddog for you, and you'll find that in addition to all the other sources we're giving you in this program, you're going to find they will go out and birddog. They'll be looking for businesses continually for you to put together for them, and all you end up doing eventually is just putting the things together.

A couple of years ago, about a year ago now, I had a friend of mine in another part of the United States that I've been working with that needed a financial statement and I was trying to get him involved with us in the area also to work and provide a large bank or pool of financial statements available so that we'd have a lot of people to work with all over the country because the more we have the easier it becomes, and what happened is I showed him how to do it. I talked to him on the phone. He was able to go out and do it, and what he did was he called me back. He not only got a million and a half dollar net worth financial statement within about a day. The person he got it from referred someone else to him three days later, and true story – he's from the Midwest – and he had almost 90 million dollars in financial statement guarantees in less than ten days that he was able to use and is using today in his guarantee program in that part of the country and we work with him. So, it's not as difficult as you think as long as you're presenting benefit because everybody wins.

Attorneys, CPAs – present your case to them, tell them what you need, explain the risk and explain the return to them and their clients. The thing is a lot of you go to your attorneys and CPAs and friends like that, and you talk about all these benefits you're going to receive. Well, they'd like to receive those benefits too because most of the transactions you're working on bring in a lot more net than those attorneys and CPAs ever thought they'd make in a lifetime. What you have to do is realize you're going to share it with them. You're going to help them also. Don't be afraid to share the wealth because the more you share the wealth, the more you're going to have. Let me tell you something, it took me a long time to practice that because for many years I would say it. I'm going to have great pain trying it, but it does work.

Advertise in the paper. Again, if you're looking for a business or a guarantee or a statement under a million dollar net worth, again try a small local newspaper, things like that, maybe your local business newspaper. If you're going to go over a million dollar net worth, I'd suggest putting an ad in the Wall Street Journal, and again if you have been following this publication, you'll find there are ads in there. I'm sure there are graduates of our program or people that have ordered this tape and you're going to find that what happens here is it does work. You will find people that will come forward. What you have to do then is have something to show them that makes sense, that they can win in, that they're not going to lose in the area.

The last thing is advertising in our business report, and we have different programs. If you want to contact our office, you can find out, but the thing is we have a lot of people every month that advertise in our national newsletter that we put out, and they advertise for financial statements, and when you're reading the newsletter you're going to find other people in there that are advertising the fact that they have a financial statement. What do I suggest you do – read the newsletter and call them, and put the thing together. It's not as difficult as you think.

I want to tell you something, when you sign that contract with a person that has a million dollar statement, you do realize that you basically almost have half of that thing yourself. You're going to feel like a millionaire. Why? Because you are part of a group that has fantastic net worth. Try it, you will like it. It is merely fantastic.

The next category we have here, category four, is the real estate guarantee. When you look at this category, the thing you have to realize is when a person's in business, a person selling a business, a person is starting a business whatever it is, people always like to put guarantees on things, and the thing is although a financial statement is a good thing, very few people in the country really want the guarantee of a financial statement. Some do, but most of them love real estate.

When a person's selling a business, talk to them, say, "Hey would you like to carry back the financing against your business?" If they start to balk, if you just mention it to them even if you have it available, would you rather the lien or the note that you're carrying back, the financing you're providing, would you like to have it secured by the business down the street? You'll find lo and behold, most business owners even though they have a fantastic business don't feel very secure by placing a lien against your business. They'd rather have a lien against the business down the street, even though they don't know it. If you really want to get to them, and again, we do this every hour of every day, ask them if they'd like to have real estate.

Now, keep in mind, do not start to offer financial statement guarantees. Do not start to offer real estate guarantees unless they're required. Why? In most cases, they are not required. Okay?

Now, let's take it from the other side for those of you selling. Number one if you go to the other section on financing, if you work it backwards, you can finance the business 100 percent when you sell it. If you decide, again I'm repeating what I said before, if you decide to sell that business and the buyer is not strong enough, why not have them go out or help them in finding somebody that does have a statement that will come in that will provide that security you want or the real estate especially, because the real estate is what everybody loves to have in their business because they feel it's safer.

As we go through this, I want you to realize, everybody wins in this situation, and if you'll just be patient whether you're the owner of the real estate, the person selling, the person buying or starting, be patient as we go through this section and you'll find everybody wins. It's also very simple.

Now, last, we can create a marriage between real estate investor and the entrepreneur. Don't panic, I'm writing in a business sense, not a Biblical sense. Now, keep in mind one thing, we're talking about a marriage. Many years I've worked in the area of business ownership, business education, financing – what most people don't realize is I also work a lot in real estate. We own a lot of real estate. I don't work there as a broker-broker even though I have a license in that area. I basically work on real estate that I own.

Now, this real estate guarantee program has been used for some time on an unlimited basis. It was created to give the seller the financial and emotional security he wants, and that's basically what we've done a lot of over the last few years. When I purchase real estate, I come up with real estate. Everybody thinks that really I want to own it. Well, it was another benefit. I was using it as guarantees or other securities on the businesses we were buying or friends of ours were buying, and we're using that as part of our vehicle. So, it's always worked out very well.

You may have come across a typical situation. This again, let's repeat, the seller would rather have the financing of the purchase based on the business across the street rather than his own. Often a seller would appreciate real estate. They love real estate. If you're able to use real estate – yours or someone else's guarantee, it means you can shift the purchase loan from the purchase of the business and that business will be free and clear. Again, we're going to develop that and show you how we do that.

For those of you sitting there wondering, there's so many ways to take this. I can actually spend 20 or 30 hours putting together a program just showing the variations of using real estate as a guarantee, but once you get started and start to use it, you're going to find how well the thing does really work.

Keep in mind, also, in a lot of transactions in business, the buyer of the business or the person in the business does have a lot of real estate, but the problem is does the buyer of that business or the person in that business have the real estate that the other party wants.

Once you start to go out in the marketplace and realize there's a variety of real estate available for a guarantee that the people will put up in a win-win situation, what you're going to find is you can quite give them exactly what they want, but if it's an office building within a reasonable area or an apartment building within a reasonable area, or land, whatever it happens to be, and they give you a reasonable parameter or area to look in, what you're going to find is it works out very well.

Again, I've had many people over the years. Again, for those of you familiar with consulting that will tell me that they want something within 14 feet of where there business is as a security. What I always do is sit down and talk to them and ask them why, and suggest other things, and ask them how they feel. In almost every case, they expand their opening, and the other thing is, I then will come back with five or ten pieces of real estate in other areas, even other states. The thing that always fascinates me – if those pieces of real estate are good pieces of real estate with appraisals on them, you're going to find that the average person loves them no matter where they are. They love real estate which I think is great.

Again, if you're able to use real estate, you can finance 100 percent. Now, in this example here, I'm going to talk about it, and then, as we go to the next page we're going to show you the example.

Say you were going to buy a business for $500,000 that requires $100,000 down, and the owner says, "Hey, I'll finance the $400,000, but I want the $100,000 down." Now, the carry back loan because the owner said, "Hey, I would rather not have the business as security. Can you provide real estate? And, I then will take the $400,000 you owe me, and place the $400,000 as a lien against the real estate." Sounds fantastic.

Keep in mind, it benefits you as the buyer or the person in the business, but it costs money, so you have to make sure you can afford it.

Now, the carry back loan again is transferred to the real estate for a fee. You then have a $500,000 business on which to borrow because if we move the loanee loan which we are thinking of placing on the business and move it over to real estate, how much of a loan or a lien do you have on the business? None. How difficult is it to borrow the $100,000 on a $500,000 business asset value that's free and clear? Think about it. Even if you don't have good credit, many lending institutions will lend you the money anyway. Why? Because the security is so out of proportion of what you're trying to borrow.

Now, up to now, the real estate guarantee has had three main groupings, and as you noticed I like to group things and categorize things. It must go back to the days in engineering school.

First of all, a person puts up real estate as a guarantee is paid a ten percent fee per year. Example - $40,000 a year on $400,000 of real estate equity. Now, supposing the person with the real estate owns a piece of land out there it could even be encumbered, an apartment building, whatever. They have $400,000 equity. Again, we don't want to use the last part of the equity as you'll find out, but on a debt equity that we are using - this is equity that they can't use anything else for – we will end up paying ten percent a year.

Now, if they only want to do it for a year or two years or five, we can structure anything, work the thing backwards, but the key thing is we're paying this much, and what they end up doing is getting a fantastic income on what? On something that they normally wouldn't get an income on.

We first did this a couple of years ago on a large piece of real estate in the Midwest. We had an apartment building that was 200-300 units, somewhere in that category – I don't recall know – but, I do recall the occupancy was 47-48 percent occupancy. We had a lot of empty apartment buildings. We then used the X number of million dollars of equity that this apartment building had, and we used it as a real estate guarantee, and do you realize that even though it was under 50 percent occupied, but putting it under a real estate guarantee on business, do you realize that real estate was them making what? Positive cash flow.

I mean, you can take land, junk land that you have it out there as long as we can get an appraisal on it, as long as nobody's going to get hurt, and you'll find that people will pay you ten percent return. Again, is it always ten? Ten percent is a starting point. Some people only want seven or eight, and end up at that level. We have others that end up at 15 or 20. Again, the key thing to keep in mind is it's negotiable, and as long as you are reasonable in what you're asking for, you're going to find that you can put it together, as long as everybody wins.

The second category – the person puts up the real estate as a guarantee and receive six percent a year and a piece of the tax benefits. That's also part of the ownership. What we're doing is we have different categories. One is ten percent. What you're going to find is when you're working on businesses that make a million dollars net before taxes and above, ten percent cash flow can be provided pretty easily and still leave enough benefit and dollars so that you don't have a dangerous situation.

As you start to get down in businesses that make only maybe $50 or $100 or $200,000, you're going to have to temper the thing because ten percent is going to pull out too much. So, at a million dollars and over, I find very few cases where the ten percent cash or above does not work.

You're also going to find that certain people want tax benefits or they want ownership and they don't want the other, or they want a combination. So, what we have is we have a combination program. First of all, you can get all cash. Secondly, you can get tax benefits and cash, or thirdly you can get a piece of the business which gives you tax benefits and cash or combination. In other words, we can give you part ownership, part cash, tax benefits – anyway you want to structure it by working the thing backwards, as long as each party in a transaction will be fair.

Now, even without a financial statement, the real estate guarantee plan allows you to finance almost any business purchase – start-up, expansion. Why? What you're doing is putting up something else as security. The person putting up the money wants the security. You're giving them what they want, or pretty close to it.

Let's look at the next page now and look at an example. We have this $500,000 business we already stated. It's going to require about $100,000 down. The owner then is going to finance $400,000.

Now, let's take step one. The business is priced at $500,000. That's in the left column. As you move over to the right column under real estate, we're looking at a piece of real estate with a million dollar value. There's a first deed of trust or mortgage or a lien. They've already took out a loan or they owe money on that real estate. There's a lien against it which means if you take the value of the real estate, and we're taking about with MAI appraisals. We don't just take somebody's word for it. We get an MAI appraisal and then we verify it. You should do the same thing. A million dollar value – it has a $200,000 lien. So, what's the equity left in it? $800,000.

We don't want to place liens against real estate where we take all the equity. If we do that we then put the person that owns the business in a dangerous situation because what happens if the value of the real estate falls, which happens as you know occasionally – not occasionally. In the last few years, it's been happening quite a bit.

So, let's take step two now. Step two – there's $400,000 owed to the business owner. We aren't going to place a lien against the business for $400,000. The owner wants the lien against the real estate. So, we put a second deed of trust or mortgage against the real estate. Now, is the owner of the business that is now going to have a lien against real estate in a safe position? Yes, as long as there's enough equity remaining, and right now on this million dollar value even with two liens on it, how much do we have left? $400,000.

You're going to say, "Well, does 40 percent always work?" No, I can show you farm land in the Midwest if we had used something like that. Those things have fallen even more, and you can hurt somebody. What we have to do is take it on a case by case basis, year by year, and always go super conservative.

Number one, we don't want to burn the buyer, the seller. We don't want to burn the owner. We don't want to burn the bank. We don't want to burn anybody. If you get in a situation like that, let me repeat, there are other types of ways of financing. Let's not goof up this program.

Now, step three – why would the real estate person do this? Well, you're going to find that the real estate owner will allow you to place a lien against them as long as two things happen. Number one, we tell real estate owners and we do perform in this area that we are only go to place a lien against their real estate and give them a return if one thing happens. Number one, we are only going to put them in a situation where the business that they're in the joint venture with or agreement with has the same risk factor or less. In other words, they are going into as safe or safer position. Do you understand what I'm saying?

Now, for those of you in real estate, it's like shifting a loan. If you have real estate A and real estate piece B, many lending institutions will allow you to shift first and second loans against those real estate properties to another piece of real estate, as long as what? The second piece of real estate is as safe or safer then what they had as security before.

So, the key thing is what? As much or more safety. If you have that, you're going to find that's one step that you've gotten by.

Now, the real estate owner is now going to be in a situation where they have the same or less risk. Now, the real estate owner now is going to be paid $40,000 a year and this is on debt equity. This is cash they wouldn't normally have. This is cash that on a lot of pieces of real estate takes that piece of real estate that's losing money or breaking even and puts the thing in the black. I mean, think about owning a piece of real estate. You have a million dollar debt equity sitting there. We have people in business that will pay you $100,000 an above a year to use that, and let's face it, real estate doesn't have much cash flow.

We see this category as the wave of the future. I hope I'm around ten or 15 years from now to see what the real estate people, my good friends in real estate, have done with this type program because this has to be one of the best areas as maybe real estate loses benefit, where we in business in a joint venture can provide them with cash flow, with them then providing us a little more security.

Again, the $40,000 can be part cash, part equity, tax benefits. Again, it's negotiable and as long as you're fair on each side, you're going to find that the transaction works.

Now, once we have placed this $400,000 lien, the buyer's still going to need the $100,000 for the down payment, and what they normally do is borrow against the business of the corporation of $500,000. Now, that is not the only way to finance. In this transaction here, we're doing it simple as possible. As you go through the rest of this program, you're going to find there's many other ways that are simpler, easier, and will cost you less money than going this way.

Now, so what we have is we have the person with the business getting a lien against the real estate. We have the person with the real estate receiving ten percent, $40,000 a year plus other benefits. Now, the owner of the real estate, not only has a lien against the real estate, they get cash and then what do we do. We then give them a second lien against the business. It's an offsetting lien. Although we now have placed a lien against the real estate for $400,000, we're giving them a second position in a business for how much? $400,000. So what is their overall equity differential? It really hasn't changed at all. All we've done is give them equity in the business for using up some of their equity, and if they're willing to do that, we're willing to pay them a certain amount of money or give them benefits, ownership, whatever they want. As long as you can set it up so everybody wins, you're going to find that people don't mind doing this.

The acceptance has been very good. We do this all over the country. In fact, ever since we started we've always had more real estate under contract as guarantees than we've had statements. And, in both categories, we've always had more people under contract willing to do it, then the people like yourselves that needed it.

Now, in the past, the real estate program had it's glitches, oh did it ever. It still has today, but not as much. The real estate owner would say, "I'll put my real estate up, but you have to guarantee the business." This forces us in the position of having to send our CPAs out to confirm the business appraisal. Then the business owners would respond, "Fine, now we want you to verify the value of the real estate." Very much of that, and the costs would pile up to a frightening amount. We had to put up so many guarantees that the transaction didn't make sense especially to us the people who were trying to facilitate it. So, we backed off from the working program until we could come up with a more pragmatic approach, and now we think we have the answer. We call it risk matching, and I'm going to give you an overview now.

In the next couple of years, we expect to come up with a mathematical approach to measuring risk in business the same as we came up with eight or nine years ago when we came up with pricing a business. Again, it's going to be a mathematical approach. We should have it out in the next two years, after we verify more of it.

What we do now is we place real estate into one of five categories – real estate with positive cash flow – apartments and shopping centers, category two will be real estate that's break even, three will be real estate with negative cash flow, four would be currency land – currency land if you don't understand is land that holds the earth together and doesn't serve any other purposed, and then encumbered currency land. Five basic categories – there's more than that, but these are five general categories.

As we proceed in the following months and years, these categories will be further refined. We then will be able to show the people in business what the risk factor also is on the real estate side. We already have that available to the real estate people to show them what the risk factor is in the business they're getting involved in.

Keep in mind, we try to keep them over $100,000 net before taxes and over ten years in business. We're trying to keep them going into businesses or guaranteeing businesses that have a failure rate of one percent or less. Why? Because what we like to do is have a very little failure. With the average failure rate, plus doing it right, the chance of these people failing should be a little remote and almost none, which is what we're shooting for. So far, so good.

The program will match the real estate category with a business counterpart. For example, the highest class of business would be ten years old or more netting $100,000 with a very low industry rate. We would then match them up with comparable real estate. So, every knew exactly where they were. We still verify the numbers, double check them, but we have another to go on.

Again, our weighted value system that we have in pricing businesses works, and we hope to create the other. Again, give us another year or two, we'll have the program finished. Our goal is to have a computerized program in order to quick risk match a business to the appropriate real estate. Because of the public's general nature and natural feeling about the safety of the business, we probably will assign our lower risk business to a slightly higher real estate, as long as the condition exists because let's face it, even if real estate and business had the same risk, we'd never be able to put them together because everyone still would assume that real estate's a little better. So, there's going to be a little waiting in there. So, you understand.

We'll be able to enter a piece of real estate into the computer and get a print out of all the available business it could guarantee. Conversely, the entry of the description of the business will bring a print out of the real estate available to guarantee it.

We already have pieces available. Again, you're going to have be patient. The real estate guarantee program will probably take longer to bring to its final state we were to use simply because there are more variables. Again, it's absolutely essential to get everybody involved as protective the greatest way possible. It has to be another one of those win-win systems, or why bother? You're wasting your time.

The last thing we want to cover on the next page is how do you find this real estate. I mean, we talked about, but how do you find this?

First of all, the number one source has to be real estate brokers, and this is what I do. I get a lot of talks at real estate meetings. I talk to real estate friends of mine, and no matter what they're working on, most of them are aware of larger pieces of real estate that they will pursue, look into for a fee, and what happens is by having them birddogging for us and try the same thing, you're going to find this work. Don't tell me you don't know a real estate broker. There's somewhere between a million and a half an two million of them in the country. In fact, my thing was that eventually everybody will have a real estate license. We're getting close to that now.

Again, especially talking commercial brokers, industrial brokers and present your case. Talk to real estate exchangers, again, a good source. Number two is actually better for me. And, also if you're wondering how to find these people, you can go to the board and they'll give you a list or you can just go to the yellow pages, and many of these people are in the yellow pages listed by specialty and you can call them and talk to them.

Again, if you're having trouble explaining it to them, why don't you just sit down and let them listen to this tape, and I think they'll understand. Have them listen to the tape the same time they're reading it and it will then dawn on them what we're doing if they're not already familiar. We haven't reached all the brokers yet, but we're trying.

Advertise in the newspaper. You're going to find smaller real estate, usually up to about a million dollar equity. Again, we're talking about using the local newspapers. Again, if you're looking for a larger real estate, and you need over a million, again, use the Wall Street Journal. Again, we use the Friday Real Estate section, which is the big section, and again for those of you that have very large businesses, well over a million, we might even consider advertising on Friday in all the editions that the Wall Street Journal has.

Are there other sources? Yes, but you're going to find these work very well. Also, I suggest you might also try advertising in our business report, and again I'm not trying to plug this. What I'm trying to show is the source that works very well for us. In addition to having a lot of people advertising that want financial statements or would put them up, we also have people advertising every month in there that have real estate that are willing to put them up. So, contact them, work with them, find out what they have, and put together the transaction, and what you'll find is you'll have the real estate to use.

But, keep in mind one warning I keep trying to put across, it works very easy – putting these transactions together is not difficult. The problem is before you sign the final papers make sure there's enough cash flow left to fund all these things you're doing, because it does cost you extra money. And, one last word, in most cases if you do it properly you will not need a real estate guarantee or a financial statement. You will not need to have costs. So, don't go out offering it in front. Just know and realize that behind you, you have this available and it does work.

LESSON 8

In this section on location, and as you turn to this section, let's just read the top part of it because it's the most important thing. Again, we say, "Location, location, location." I don't know where this started, but years ago, the real estate people started talking about this that the three most important things in real estate were location, location, location, and basically they have the same thing in business other than the fact that you're going to find as you get involved in business there's a couple of things that are more important like the category of business, the category of business, the category of business. Why? Location's very high on the list, but you're going to find in business it isn't the highest category, and what we're saying here, again when they first came up with this, but no amount of ambition, hard work, or good management will overcome the disadvantages of a poor location. The key thing you have to keep remembering when you get involved in business whether a start up or existing is many of you have a hard time understanding why certain people in business make a lot of money and others don't, when other people work 80-90 hours a week and others take it easy and seem to do very well.

As you start to talk to them you're going to say, "It must be the IQ level. It must be the money they started with." It's none of these things. It's just that they were either lucky or they knew what they were doing and they stay away from certain areas.

Now, as you go out to look at a business, you're not going to find a perfect ten. We say you'll find an 8.8 or a 9.2 and you ought to be satisfied with that because those of you that go out looking for tens end up doing nothing in your life. Why? Because what you're looking for is something that doesn't exist.

When you get to location, I'm going to tell you something. If you're in a business where the location is important, then you better make sure you get a good location. Now, when you're dealing with a lot of companies like manufacturing, location's important from the standpoint that you need railroad sites or you need truck transportation. But, in most areas the location of the manufacturing company since you don't have customers coming to your plant is not that critical. It's also not as critical for things like distribution companies or service companies where you really don't have the public coming to your office. I mean, you could be in a cubbyhole somewhere. If you're in the service business and the public does visit, then fine, but you need a location.

Now, as you start going through this, let me go through the exceptions because although you can go out and buy the books that tell you about all these location things that you need, let's take you through specific things that you make mistakes on. Keep in mind also as you read these books, they're not going to help you other than to give you a general idea because the information on location even if you're an expert varies from location to location. If you happen to be in a city of 400 or 500,000, you may find that there's 50 areas in town that have specific location problems. There may be 5,000 areas, and what happens is although some of the information is transferable, the key thing that it has to boil down to is common sense.

An example I try to use all the time, are you a person that goes out with your family to have things dry cleaned? So, when you go out to have things dry cleaned, when do you have it done? You're going to find most of you are going to say, "Oh, I have my dry cleaning down on the way to work. When I'm on my way to work, I stop off. I have my clothes dry cleaned and I pick them up on my way home or I pick them up the next day or a couple days later." That's fine, and that's what 90 some percent of the people we talk to say. So, if you start to think about, if you just go back in the recesses of your brain or your common sense and draw this out, you're going to find in most cases you have the common sense. What happens is when you make a mistake on location, you're deviating from your gut level feeling, you're deviating from what your common sense is telling you.

Now, when you talk about the super owner/operator, super owner/manager, you're talking about a person that has a crummy location. They're about 40 miles out in the country. It takes 7,000 left turns and 8,000 right turns to get there. You have to follow somebody very slowly because if you get lost you can't find it, but why does this business make a lot of money? There's a super owner. There's a super manager. They work a lot of hours.

Now, considering yourself going into buy this or you're going to start something like this. I want you to keep in mind that you're average. Again, even if you're not average, if you don't start to analyze yourself and your team based on this, you're going to go out and do stupid things based on the fact that you think you're better than somebody else. Everybody thinks they can take a crummy location with a restaurant sitting there that's closed four times, and they can open up and do well. What happens is they end up failing. We end up with four owners a year in that crazy stupid location. I'm trying to convince you to tear it down, build something else there because that doesn't work in that location.

Now, we talk about the super owner/manager also you're going to say, "Well, I can buy this for this right price." So, you buy it. It's priced right. The financing's fantastic, but there's two things you have to keep in mind. Number one, what is the chance of you going in there and running that properly and making a success of it in five or six years, and then turning around later and selling it to somebody else providing the next owner with financing and then succeeding? Because in order for you to succeed in business, you have to be able to go into that business, succeed and then eventually sell it to somebody else and get your money out. And, if A plus B don't happen, you have a failure. So, what is your chance of A plus B, mathematically it's way out there.

For those of you who are brokers, do not list these businesses. These are the ones that provide the lawsuits. Give the seller a big hug and suggest they sell it themselves. Do not get involved in these. Don't buy these no matter how well they're priced.

The next area is the franchise location, and you have to realize that most of the franchise locations in the United States which is over 50 percent of them are second, third and fourth grade locations. Think about it because I ask this question all the time. I say, "Okay, we have a McDonald's operation." McDonald's is fantastic. It's backed up by the McDonald's corporation. They're a billion dollar statement. Would you build a super

McDonald's? And, they say, "Yes." Okay, we now have McDonald's franchise is one of the best in the United States, best in the world. You now have the Arthur Hamel Ficky Wicky company with a net worth of $2.43, with a class franchise, and an average person would you build? And, very seldom do I find anybody that will build. Why? Because although the franchise is fantastic, they don't have the statement. They want A plus B.

Now, if you go out in this world and you buy a franchise or your client buys a franchise, and they have an average statement, what do you think the chances of ending up with a good location? You're going to find when you starting out this way, you don't get the better locations and you end up with the second, third and fourth rate locations although the average person in this country would assume because it's a franchise it has to be good. It doesn't happen that way. In fact, it's just the opposite.

I was talking about the common sense approach. I'm talking about standing on the street corner, and again, you can stand there with your clipboard, but usually you and I can stand on the corner and we can tell by looking at the cars going by where they're going. When you see station wagons coming by and you see women sitting behind the wheel with their hair up in curlers and chenille housecoats on, they're usually taking the kids to school or doing something along that line. You could figure it out.

You can go to the cities and counties and find out what the traffic is, but while you're standing there why not use your common sense? Let's start going through that form a common sense standpoint.

Now, as we turn the page and talking about location, we're talking about smelling the air, standing on the corner. If you have a location where people have to drive into it, why don't you get into your car and drive up and down the street and see what the problems are getting in, getting out, try at different times of the day when you have traffic or you don't have traffic. If it's a walking location, why don't you get out of your car or get off your bike and go and walk. Find out what the problems are parking in the parking lot, getting there, and even talk to some of the people there and find out what they think about it. Again, you're doing research, but the more research you do before you start the business or before you buy that existing business, the less chance for failure. So, everytime you talk to somebody in the area, talk to other business owners, continue to ask questions about that business or the location and you're going to find you're going to pick up an awful lot of information.

Now, one of the first things we're doing is we're analyzing the city to find out what kind of thing we have in this city or what kind of traffic, and again, as we start to think about this and break it down – traffic – what is the amount of traffic, and you're going to find we basically have a normal curve. In the business, we're always saying as you get up to 18-19-20,000-22,000 cars a day the traffics fantastic. It builds up. Do you realize that the traffic builds up it's a normal curve? And, it comes up one side as it hits 20-22,000 guess what happens as it starts to go above that figure. If you understand a normal curve, it means that it comes down the other side. In other words, the traffic and the business builds up to a certain number of cars a day, and then as you get above that, guess what happens. The business then falls off just as fast on the other side of the curve. You're going to find too much traffic is a problem also.

And, if you don't believe that, in your town or city that you live in, I'm sure there's at least one street that has a lot of traffic in it and there's probably a lot of franchises on that street. There's a lot of little retail stores. Why don't you drive down that street later today or tomorrow? Try to get into the traffic. Try to get out of the traffic. Go there when it's really busy, maybe five or six o'clock, and try to pull into a restaurant or a business, and then you get in there, spend a few minutes and then try to get back out into the traffic and see what kind of problem you're going to have and find out. You're going to suddenly realize why the business isn't doing well, or not doing as well as it should be, or maybe why you shouldn't pick that location.

The character of the traffic, and basically we're talking about the same thing we were talking about before and that is knowing time of day where they're going. We talked about that before – the station wagon, people in the morning going to work, in the afternoon coming home. In the afternoon people are going out doing what? They're on shopping trips. Depending on where you're located, analyzing your location, but you can do it by just standing there and spending X number of hours over a few day period, and you're going to get a very good knowledge.

Since most of you listening to this tape are the people that are going to be buying existing business, you're going to find your hindsight is going to be fantastic as your sight. Why? You're going to see it's already been making money, and then just make sure that you're not fooled by the things we talked about in the first page which is super owner, franchise location. Don't let that blind you. Check them out even though something tells you there's not a problem.

The origination of the traffic – where's the traffic coming from? Where are the problems with that traffic getting there? What are the problems with that traffic at certain times during the day? We've talked about that.

Now, as we start to talk about characteristics of the traffic, we're talking about how fast is it going. In other words, do you have traffic going by your place of business or the one you're about to by, and traffic is moving at 55 miles per hour – moving at 50, 45? Have you ever gotten into traffic at 45 miles per hour and try to pull into a driveway or get out of that traffic without getting killed? And, you're going to find unless you are a race driver, or a stunt driver, you're going to find you can't get in and out of the traffic, and after you get out of the traffic, how do you get back into the traffic again? Unless you're able to go from zero to 60 in about two and a half seconds.

You have a problem. How do you find out about it? Go out and go out in the sun and find out what the problems are. Get out of your car or if you're in a traffic area, drive your car. Find out what the problems are getting in and out. The main thing is to do your homework. Don't assume anything.

The other thing you have to worry about it is you're on a street that has a lot of traffic, how much of a curb cut do you have? The cities today, to speed up the traffic because of the increasing traffic in all cities, like to cut down the curb cuts. In the old days, we used to have 30 – 40 -50 feet and you could pull off, and you were doing 25 and you pull off and you had traffic coming out and traffic coming in. You had plenty of space.

Now, they're trying to get it down to 20-25 feet. Did you ever try to pull out in traffic at 45 miles per hour and pull into a curb cut or an opening in the street where you barely have enough room to get in with another car pulling out? Try it some time. You're then going to find out what the problems are and why people are not going to that location or in the future why people won't go. Why? You have a basic problem. And, if it's building up and it's bad now, think of what it's going to be like a year from now.

The next thing we'd like to take about is the crossover, and the crossover is the lines in the middle of the street, and what they do is they're broken. It enables you or a client of yours, a customer, to pull in the middle and turn left on these crossover lanes.

Now, years ago we didn't have these, and what we basically had is we had the dividers down the street. We had a lot of traffic. As the freeways and other type of expressways started to relieve traffic and pull traffic off the side streets or the main streets of your town, they put in crossovers which was fantastic. It increased your business.

In the last few years, we have quit building more highways and we have more cars on the road, and more traffic on your local streets. The cities now are getting rid of a lot of these crossovers and you'll notice it. They'll have the crossover, and then all of a sudden it won't be there, and they'll have little bumps down the middle of the street. Then, you'll have a concrete divider about two or three, four inches high, and then they put one up about three feet high.

Now, let me tell you something. As you're going down there, you have to realize especially if you have a retail business, this could cut your business in half. All I can promise you is it will cut your business enough so that you will not be in the black anymore. You're going to be right in the red.

So, when you start to find out these things are going to be put in, I would suggest that you and the other merchants get together and have these things moved by going down and talking to your city hall, and figure out ways to influence them because if you don't do that you're going to have a problem.

The next thing we talk about are physical characteristics of the site – how big are they, things like this, and again, when I start to talk about this keep in mind, is this thing going to benefit you in the future. In other words, are you going to have a problem with the size?

If you're in a basic area and you have a retail store and you find the first people went in there ten years ago, and they were able to get by with 20,000 square feet of land for parking, the whole thing, is that going to work today? Are you going to have enough parking? If you find you're short of parking today and you're planning on doing a little expansion on your building, are you going to have enough parking for five or ten years from now? And, what you're going to find is you may find that your sales are up to a certain percent of X-number hundred thousand a year and you can't go any further. Why? Because the location you have does not have the parking, the access, whatever to continue on and you're going to find then if your sales level off, you're going to find the profits start to go down. Why? Because once your sales level off in any business, you're going to find the rule always is your expenses continue to go up. Which what happens? Eventually you're going to break even, and on a great business you have, you're going to end up losing money.

Again, we've already talked about the accessibility. We want to find out how accessible it is because we talked about the problems with the traffic, how fast it's moving and also how much room they have to cut in and cut out, and you're going to have to check it during the day because sometimes it's going to be bad and it might be the wrong time of day when you're checking. So, check the busy times – the morning, the afternoon, the evenings.

The next thing is visibility, and years ago we used to say you need this great visibility, and we used to say 15-20 years ago in franchising if you had a franchise location you had 50 percent more business, maybe twice as much. What we now have are a bunch of ticky-tacky little franchise buildings up and down our streets, and you're going to find in most cases just having a good location on a strip center on a corner will be absolute visibility. It's not only the less expensive way to go, you're going to find you're going to have just as much volume as you have out in the other areas. So, keep that in mind, but you do want the visibility, but you lose the visibility when everybody has the same thing. You have to find some way to stand out from your competitors.

The last thing is location – now the neighborhood because a lot of you get hung up on the neighborhood, and since many of you listening to these tapes are not going to be running your businesses. Why do you get hung up by the location? If it's in a neighborhood that scares you or frightens you, and it's being managed by your manager. The managers making deposits and you're not there very often, why are you worrying about a condition in a neighborhood that maybe you don't want to live in? Because what's going to happen is you're not going to be there anywhere. It's the same reason years ago we used to send many people in our classes on field trips to visit funeral homes. Not that we wanted you to buy a funeral home. We wanted you to think about getting involved in a business you wouldn't normally think about getting involved in because we find the average American public goes out and buys three, four, five percent. That's there need. They just want to go after three, four, five percent of what's available.

The other 95-97 percent of the companies that are out there, people don't think about because everybody wants to own a carwash, a gas station, a bar. Again, they're nice businesses, but why not look at the yellow pages and think about the other ones that are there. They're equally great and in most cases they make even more money. Try them.

LESSON 9

In LESSON nine, we will be discussing franchising, and as you start to consider franchising, the thing you have to remember as we go through this area, and that is you're going to have some good news, and you're going to have some bad news.

The first thing that you have to remember is if you decide to get involved in a franchise or if you're checking out a franchise or even if you're involved in franchising right now is realize the problems we have nationally, and I mean from the franchisor's standpoint which is the person selling the franchise to the franchisee standpoint which would be the person which is yourself which might be buying a franchise from one of these large companies or a small company.

The key thing to realize as you get involved in a franchise is to check it out. Check it, double check, and triple check because as you start to do this you're going to find there's always some good news and some bad news. Also, the thing you have to keep in mind if you're getting involved and you're going to become a franchisee is if you happen to be a very strong person, and you're a person that doesn't like people to report to other people you may find you don't like the area of franchising because the bad news in franchising is that you're going to have somebody over you. You're going to have somebody that are actually going to be telling you different things that you have to do in your business and things you can and can't do, and if you're a very strong person male or female, you're going to find that you don't like that.

The good news is on the average is the franchise business has a lot lower failure rate than businesses at large, and I'm talking about the start-ups and the existing. So, we have some bad news. We have some good news. Nothing's perfect.

One of the first thing's you're going to have to realize is you're going to have to go out and check this franchise, and if you look at section nine, page one, we start talking about the state corporation commission in your state. We find there's about 20-some states that actually have state franchise laws of different sorts. Some are called "Business Opportunity Laws". Others are called "Franchise Laws". And, they exert influence over the sale and resale of business opportunities and also franchises.

Now, the ones that have to do with franchising are basically full disclosure in that the state is asking you as a franchisor or owner of the franchise to disclose to the next party all the pertinent information. In other words, tell the truth, and even if the truth is something that may be of a felonious nature, you're going to find that as long as they disclose it, they're okay.

One of the things we do when we're checking out franchises is check with the State Corporation Commissioner and the reason is we're trying to find out what problems have been registered from a legal standpoint against this franchise.

The other thing we have on the first page, if you look at the International Franchise Association, we've given you the address and the phone number, and the reason we have – this is the lobbying arm of the franchisor. They're a great source for checking out franchises to find out what the status is, how many there are, and they'll give you a lot of valuable information. You can either write to them or give them a telephone call.

We also want to mention with gathering information, the Small Business Administration has put out a lot of books on franchising as had the Department of Commerce and Transportation, and you can find these at your government bookstores, but the thing you have to keep in mind in the last couple of years, there haven't been a lot of new updated versions put out. So, you may have to do a little digging at your library in addition.

Let's start talking about the laws themselves now, because if we talk about the main law we have the National Franchise Law. This is the National Franchise Law that was passed about three or four years ago, and in this law, it was passed at the national level and it is administered by the Federal Trade Commission and basically it is a full disclosure law in that the franchisor has to tell the franchisee all the pertinent information about how well they're doing, who the officers are, and what their track record's been and how many franchises they really have sold. It gives you a lot of good information.

The thing you have to realize is though, they do not have to give you a copy of this document if you're buying an existing franchise, but what I'd like you to do is go back to the franchise company even when you're buying an existing one and ask them for a copy of the disclosure statement at the national level.

In addition, we've already mentioned there's 20-some states who have other requirements, and you might find if your state or the state you're going into has this requirement, and if they do, you're going to find there's also another document that may be similar or the same as the national document depending on what the state law requirements are.

The key thing is it's going to give you information and also in most areas, they're going to have a thing called "audited statements" which means it will give you the financial information on the franchisor, and the thing that amazes me year after year is most of you end up going out checking the franchisee and you find the business you're buying from another franchise person is doing very well. It's making a lot of money. But, then when you read the franchise document, it goes right over your head as you read the fact that the franchise company is losing money every year. Don't you realize that you have a two-step program here? You have a franchisor and a franchisee, and even if you're going to become the franchisee, if the franchisor is in trouble or the franchisor is not doing well, there's a good chance that you may end up losing the whole thing. Why? Because the top part of the company will go down the tubes.

Also, it makes me very suspicious. I mean, how good is a company going to be in the long run if the people running the main company can't even run it for a profit? There has to be something wrong there. So, I'm very suspicious in areas like that.

As we turn the page and start to consider other areas, one of the things I want you to start thinking about now is what we call a franchise profile because if you right to your different state organizations like the Department of Corporation, you're going to find that they will send you a book, and you can check with them, a booklet. It gives you information that you as a new person buying a franchise should think about, and again, if you order these from ten different states, you would find that each state has the same type booklet with the same information.

Let's go through some of the general information that they bring up, and also it's the same as the information we bring up because it's important to analyze the franchise you're getting involved in.

First of all, the general analysis – how many existing franchisees are there? And, again we're on 9-3. How many are in operation? What's the geographical spread? And, if you happen to be in Northern Maine, what good does it do you to be involved in an organization that has 50 other units, but they're in Southern Florida. Or, you're in Northern Washington and all the businesses are in Northern Mexico.

What I'm trying to tell you is you better make sure you're in their area. You also should check to find out if they've had success in the area you're going to, and the reason I mention that is time and time again you're going to read these great stories about people that have gone in for the first one in the market, the first one in the area, and they succeed. Those stories are Mickey Mouse, and what you're going to find is although that may happen occasionally, it doesn't happen very often. In fact, the rule is the first persons into a market usually fail. What I'd like you to do is adopt a philosophy of you are going to go into a market after somebody else has made it and done it successfully, and even though you're going to say you want to be in there first, what I'd rather have you say is you want to be in there successfully. The first people that go into a market are usually not successful. Why? Because it takes time to break that ground, and usually they run out of money before they do it. Why don't you wait until after the market's established and there's a success pattern.

I keep telling you if you want to do something exciting, don't do it in business. Get a plan, go skydiving. Buy a racing car. But, in business try to keep it as simple and as safe as possible.

Franchises have failed, how many have failed, why do they fail. These are things that you should be interested in because you may be buying something – a franchise – that has a basic flaw, and you will especially find this when franchises are new. So, go out and find out. Check it out. Find out why they did fail, and again you may have to go back to former franchisees, and if you don't know how to do this what I suggest you do is when you're reading the franchise document, you're going to find a number of lawsuits that may have been filed against this company. What you might do is you or your attorney might go back to those people and ask them what the problem is, and in this area you may find out that they've had a few failures and it may be for reasons that will keep you from buying it.

The local market area – has a franchise been awarded in this area? And, the thing that comes up continually is you better check to find out what the market area is because what you usually do when you're reading your document, you assume that you are the franchisee for the whole area. And, as you start to read the document, you're going to find you have a storefront store and you have the franchise 30 feet down Main Street and about 60 feet down the side, and then as we read the fine, fine print, we find that you really only have the territory eight feet above, and there's another unit up above you and you only have it down to ground level, and you also have the basement. Yes, I've exaggerated, but you read the document and find out what your market area really is.

New products next year, the next two to five years – one of the things that gives you a lot of benefit in this franchise business especially if you're a typical business owner that is just starting out is the companies, the better ones, are going to force you to go out in the next year or the next couple of years to actually add new products, to change what you're doing. Although, you may be the person that fights it, you're going to find the American public's tastes are fickle, and again, I'm not just talking about the food business. I'm talking about what they're after, what they want to buy, what their ideas and thoughts are. So, maybe you're going to find that if you're a person that only thinks one track and doesn't think too far ahead, a franchise may be very beneficial.

Competition – what competition is there? When they're selling you on these franchises, every one of them is going to have a tendency to say there's really not any competition, but you better go out there and find out because if you're going in with a very weak new hamburger operation and they're going to put you right next to McDonald's and they're going to tell you there's no competition, I just want to tell you, I and other people working with me in the past, have heard those stories. You're going to find McDonald's, as an example, is going to take their share of the market their in, and you're going to be left whatever's left after McDonald's taken theirs. So, be careful of the competition. Check it out.

Independent versus company owned – are all the outlets franchises? And, what's the date of the most recent company acquisition? And, the reason I ask these questions is a lot of the companies are going to lead you to believe that they're buying back franchises because they're trying to expand their bottom line profit, and as you start to read the franchise disclosure document, you're going to find the real reason they're buying these back is they're being sued by franchisees. How do they franchisors get rid of these bad statements that are on their disclosure documents? It's simple. They buy them out. They buy them back. When they do that, they remove a problem, and this is done quite a bit today, and because of this you're going to find there's also a lot of nuisance lawsuits being filed? Why? Because the franchisors in many cases have to buy them back just to get the lawsuits of their disclosure document.

The next category on page 9-5 actually has to do with a franchise contract, and as you go through this tape program, you're probably wondering what documents are you going to need when you list, you buy, you sell? In this section of this program, it has to do with finding a business, we have given you a check list and if you haven't gotten to that area yet, you might go back and look at that area that has to do with finding a business because that has a checklist in putting the need for a franchise contract.

Now, as we start to get a copy of the franchise contract, and again this could be on buying an existing franchise or buying a new one, what you should do is have your attorney and CPA review it. Again, if you're going to be looking at ten or 15 of them, you don't have to bring them in at each one, but you should bring them in on the one that you're about to buy because number one you're going to find great legal problems or ramifications, and also you're going to find that there are tax problems involved. So, why not get them resolved right in the beginning by going to your professionals?

The first thing you're going to run into is a thing called a termination clause. A termination clause basically was set up a long time ago, a number of years ago, and the reason for that is back in the early 1960s we really didn't have termination clauses in our franchise agreements, and we had people like Internal Revenue come back and tell us if we didn't have a termination clause, we'd have a problem from the tax standpoint. So, what we ended up doing at that time because I was involved in franchising back in the early 1960s – what we did was we put in termination clauses for five, ten, 20 years on. The thing that happened then was we started getting into the early 70s and mid 70s in the United States, we found we started having a lot of lawsuits because certain franchise companies that were having troubles with franchisees did not want to renew the franchise agreement, and also we had franchisors that had franchisees that were making a lot of money, and they would have a franchisee making X number of hundred thousand. Why renew it? Why not just build a similar unit across the street and cancel their franchise contract? And, we ended up with a lot of lawsuits, and from what we've been able to determine, most of them were ruled in favor of the franchisee as long as they were in good stead contract-wise.

Today, in the United States, we have a number of states that have put in franchise laws that regard the termination area, and just to generalize in this area as you or your attorney do check these out, you're going to find the termination laws basically say that wherever the basic period is of the franchise agreement, say for five years, the law basically is saying that they then have to renew for longer periods of time.

In the old days, back in the early 1960s, many of the companies that I was working with went 15-20 year on their contracts. Many of these companies don't go that long today because what happens is they don't know where they're going to be 20 years from now. So, what they do is they set up a five year contract with a renewal, and then if at the end of the five year period maybe they're in some area maybe in southern Alaska and they don't want to renew in that area, a lot of these state franchise laws do give them the opportunity then to back out at that time and not have to support that area and let the franchisee go. So, it's basically to protect the franchisor as far as going short-term on the contract.

Selling and renewal – when you start to talk to the average business seller, they're going to tell you yes they can sell their franchise. You're also going to find they can renew it, and again, it's probably a defense mechanism. Their mind or their memory process has failed them, and as you read the franchise agreement, you're going to find that you can't sell and renew, or the franchisor has first right of refusal. If they have first right of refusal, you're going to find if it happens to be a very good franchise operation, that means the franchisor is going to want to buy it back. Since they're in first place, you're going to find that you're going to have to wait whether you're listing it or buying it. You're going to have to wait in order to get in position to buy it or list it. So, you better check this out and see what it has to say.

Next thing – advertising and promotion Everybody thinks that every franchise document is the same. If you want to think about it did you ever notice things for gas station saying, "At participating stations" or the advertising for a fast food operation saying, "At participating stores". Now, what they're basically saying is they're not advertising together, and what you have is you have some of the people that have an old franchise agreement. Other ones will have the new franchise agreement. The ones with the old franchise agreement are not required to advertise or put in so much advertising. The new ones have to according to what contract they have or what franchise agreement.

This does cause a lot of problems in a lot of areas because the people that aren't paying the franchising companies a fee for advertising tend to irritate the ones that do. Why? Because it lowers the amount of profit the new people make, and at the same time the people that have been in it a long time and have the old contracts still benefit by the advertising done by the other people. So, it does cause a lot of problems.

Not for long though. The major franchise companies because they will send somebody in there to get rid of that rotten apple or the person that's causing a problem. Especially, if they're rubbing the people that are paying the advertising fee, they're rubbing their noses in it.

So, advertising and promotion – incidentally at this time, we should've mentioned one thing I should've mentioned early, and that is the fact that you have to realize that since franchise agreements are different, and there's a number of different copies and examples of this company. It is possible to go back and renegotiate a franchise agreement, but you're going to find it's a lot easier to do this if you do it before you take over the business or you list the business because what happens is after the new owner's in place, you're going to find it's very difficult to go back and renegotiate these contracts. So, try to do it at the right time.

The next thing is patent and liability protection. When we talk about this area, what we're talking about is if the company is advertising that they have this specialty product and you're buying a franchise to sell, and what happens as you start to look at it, you're going to find that the patent protection and liability protection really isn't there. As you have your attorney check it out, it isn't there. So, what I'm saying is no matter what they're telling you in their literature, what they're telling you in their documentation, you better verify it and you better check it out.

Home office services – the things that keeps franchising going and the thing that keeps franchise consistent especially as you go to an operation – we talked about the

McDonald’s operation – the thing you have even if you didn’t like the McDonald’s hamburgers or the McDonald’s French fries, the thing that McDonald’s has and a lot of the other great fast food chains is they have consistency, and what you have to have is consistency because that’s what the public is really looking for in the product. What you’re going to find is the home office service is the ability of your home office to come around on a weekly or monthly basis or whatever and check it out and bring the different stores or the different businesses into line so that we do have a consistency. The thing you’re going to find if you’ve never been in business before is you’re suddenly going to be surprised to find that the manager of your business or even your employees want to change the product back to possibly the hamburgers that grandma used to make.

Now, grandma and the family loves grandma’s hamburgers, but you’re going to find the average public does not like that. They would rather have McDonald’s hamburgers, and they want that type and let’s not argue with success.

Commissions and royalties – there is no free lunch in business, so what you’re going to find is that the companies that are doing very well are actually providing services to the franchisees, but the way they’re able to do it is by charging royalties, commissions. They’re charging three percent of the sales figure, five percent, ten percent – whatever the number happens to be, and with this money they’re able to not only make a profit and stay in business, but that also enables them to come around on a weekly or monthly basis to check, verify, and give the franchisee support that they need, and that’s one of the purposes.

The next thing is training – if there’s a training provision, who provides the training and who pays for it? And, how long do you have this training? Does each owner get it? You better read the fine print.

Territory – what territory do you really have? Don’t assume because the first sentence says a certain thing that the next few sentences are not going to water down what the first sentence says. So, read it, and again, on the last one, the one that you end up buying, you better make sure an attorney checks this before you sign-off and everything.

The last things we have here is territory, and again checking it to make sure that the territory is as what you think it is, and then exclusive or non-exclusive. Do you have exclusive rights to an area or are you in an area, a ten square block area, with 50 other people that have the same rights to the same area? So, read the agreement, have an attorney check it, and don’t assume.

One last thing I want to mention in the franchise area is you’re going to run into a number of things as you go out and get involved in business, and these companies are called “licensing arrangements”. They’re called “distributorships.” They’re called “dealerships”. And, although there are a lot of legitimate ones out there, you’re going to find there’s also a number of these that are really franchise agreements or franchise documents, and what you’re going to have to do is sit down with an attorney when you do have these, and find out if you have a dealership, a distributorship, a licensee arrangement or is it really a franchise agreement. Again, I’m not an attorney, but I do want to tell you if the company that you’re buying a franchise from has set up some other type of legal form like a distributorship or a dealership to avoid the franchise laws, eventually they’re going to get in trouble. We have seen this happen a number of times, and when it did happen, the parent company ends up going down the tubes as the government issues a cease and desist order, and then the franchisees start to go down the tubes after that. So, check it. Even though it may be an easier and a cheaper way to go by buying one of these, don't do it. If it's supposed to be a franchise and they don't call it a franchise, and they're trying to get around that law – side step down the street and buy another type business or list other type businesses. They're not worth working on. They're just a waste of time.

LESSON 10

We're going to be talking about this building lease, equipment lease, sign lease, but the most important thing you're going to running into is the building lease. Years ago when we first started putting on programs, the thing we basically stayed away from was a building lease because we assumed people going through our different programs in business had gone out and signed leases. They rented buildings, homes, things like that, apartments so they were familiar with leasing.

Lo and behold about two years after we got involved in the program, we started to find that a lot of the people that were going through our program were having trouble with the lease part of it, and that was a number of years ago. In the last couple of years, this has become even more of a problem. As we go through this I hope to relate to you the different problems.

Now, as you go through this, you're going to find there's a lot of standard what we call boilerplate or standard paragraphs in different leases. As you start to go out to work on leases, I want you to keep in mind that there is a lot of standardization out there which you'll become familiar with.

The thing you have to remember as you start to get involved in lease, remember, when you're going out to buy an existing business and there already is a lease in place, you can renegotiate different parts of it and get the owner of the real estate to change that lease. The only thing you have to keep in mind when you're working on a lease is you have a basic problem, and what is the basic problem? You have to do it before you lose because if you want to be in the driver seat or at least be on the same level as the owner of the real estate, you have to negotiate these different changes before you take over the business.

You're going to find that if you do it after you take over you've closed and you're already the new owner, you're going to find that you're really not going to have a lot of leverage in working with the owner of the real estate, and you're going to find it's not going to work too well. So, try it that way.

One of the first things I'd like to mention before we even get involved in this would be a thing called triple net, and what we have is different categories of leases if you'd look at the first page called percentage leases. Before we even get into the percentage lease, I'd like to talk to you about triple net because people are going to mention a thing called triple net. What is triple net? Triple net basically means that the person that owns the business or the person called a leasee, because in a lease you have two different parties you have the leasor, which is the owner of the real estate – that's the person leasing you the premises, and the leasee is the owner of the business, and that is the person that is leasing the premises. In other words, you're the person renting or leasing out that space.

The first thing you're going to run into is triple net, and triple net means that you the leasee or the owner of the business, either or, what you're going to find is the person that is paying the taxes, paying for the maintenance and paying for the insurance, and each one of the things are a net. If you're only paying two of these three it would be a double net, but in most of the areas it's a triple net. This allows the owner of the real estate, whatever it happens to be to lease this back to you or rent to this for a basic rent and then have you pay the other areas, maintenance, pay for the insurance, pay for the taxes.

Sometimes the triple net has to do with paying the taxes above what they're paying today. Sometimes it includes all the taxes. When you get into the area of maintenance, you may find in certain cases you're paying for the maintenance on all the building and in other areas, you may find the leasee is paying for the maintenance on the inside of the building and the owner of the real estate pays for the maintenance on the outside.

Insurance also could be the same. You could be paying for all the insurance required or you might even be paying for the increase in the insurance. Again, all these things are negotiable. Even though many times the owner of the real estate is going to hand you a contract, a standard form, there's very few blanks – do not let the intimidate you, and what I'd like you to do is go through it and if you want to change things, change things. We're going to go through a number of these areas right now.

The other thing I suggest you do is when you get down to the final point, when you're going to buy that business, I suggest you then at that time bring in an attorney to have him check that final lease.

You're also going to find for those of you starting a business, and I suggest when you do get the lease back from the seller or the owner of the real estate, I suggest what you do is go to an attorney and have him review it. Most leases that are signed between owners of real estate and beginning business owners are 1001 percent in favor of the owner of the real estate, and the reason for that is the average person starting a business in this country does not know what they're doing. Number two, they don't get an attorney, they use the attorney of the seller, and they also have read this crazy book on how to do it, on how to start your own business for under so many dollars, and what happens is it misleads. It gives him a lot of bad information.

So, what I'd like you to do is go out and bring in the professionals also. Again, you're going to say, "Gosh this is expensive." Well, you're going to have to do it because if you don't spend the money in these areas, what you're going to find is you're not saving at all, and you're going to eventually end up failing.

Let's start going into the different categories of lease from the first page, and you'll find that the first thing that we have is a thing called a percentage lease, and what we have first of all is a percentage against the minimum. A percentage against a minimum that the amount of lease payment is $1,000 a month or five percent of sales whichever is greater, not less, naturally, whichever is greater. So, it's a percentage against the minimum. It's either one or the other whichever is greater.

Now, years ago, we used to have a lot of leases like this percentage against the minimum, and as you go around you'll find some of the older leases are still a percentage against the minimum.

The category that you're going to learn the most often is number two here which is a minimum plus a percentage, and the owner of the business or the real estate is going to want $1,000 a month plus a percentage of your sales every year or every month, whatever it happens to be. A minimum plus a percentage – why do they want this? Because real estate prices have gone up and owners of real estate have found that they're not getting a return. What they try to do is come back with leases like this a minimum plus a percentage to increase their returns so they end up getting a legitimate return on the real estate that they have.

You on the other hand are going to find all this is going to cut into your profit and because of this, we end up with a battle continually between the leasor and the leasee, and by battle I'm talking about one trying to increase the rent or the lease payments because they're trying to get a normal return on their business or a good return. Where you on the other hand, owning a business are going to find that this ends up eating into your profit because in many cases, these increases in your lease payments are going up faster than you're going to find your profits going up. In fact, that's one of the biggest problems you have with a lease today around the country and that is our lease costs or cost of rent of the facility we're in is actually going up faster than we are raising our prices. They're going up faster than the inflation rate, and when you have that it eats into your profit. And, this is just one area.

As you're in business, you better keep in mind there's going to be a number of categories that keep increasing faster than what you're doing on increasing in profit and sales. As this happens, you're going to find there's only one place it can come from. It doesn't come from the government. It comes directly out of your profit and eventually this great business you've been running or this great business you own all of a sudden was making X number of thousands of dollars a year is now making a lot less and eventually you'll lose money and you go down the tubes.

The next category which is percentage no minimum – on a lease like this, and again, we see this quite often with a large supermarkets or drug stores that are basically the anchor tenants where you have 14 or 15 stores in order to get people like this into their stores, the people that originally lease these out, signed a lease that really isn't very good because it's a percentage no minimum. So, if that large supermarket does move out or that large drug chain does move out, what you're going to find is when you have a percentage no minimum, even though they just moved down the street to a larger store for themselves, they don't really have to worry about the lease because they only have very small cost out of pocket. Why? Because once they move out and there's no sales, how much money do you the owner of the real estate get? So, percentage no minimum is normally not a very good lease for the owner of the real estate. It's better for you the business owner. So, keep that in mind as I go through this and tell you the good news and bad news.

If you're on the real estate side, this one's not going to be too good. If you're a person on the other side which is the owner of the business, you've done very well. This lease is going to have more value.

The last area I'm going to talk about is a thing called a maximum rental, and we see this quite often with anchor tenants in the very large regional malls where they have been able to negotiate a rental or a lease payment where the owner of the real estate or the mall and that had been built in in very small print or in a last page of the contract a thing called a maximum rental which states that although they are starting off paying $100,000 a year for lease payments, this amount during the five, ten, 15 or 20 year lease will never go beyond a certain amount, and again, in the past most owners of the real estate did not get hurt by this because as long as the inflation was running say under five percent, it didn't hurt them.

What we have found last years as we've had a few years where the inflation rate has been over five and up to ten percent, these people are now starting to find that they are having to add in these large anchor tenants are now going to be paying $200,000 a year in rent, and all the extra now is having to be picked up by the owner of the real estate. What does that do to real estate value? It knocks it down. Since we're now taking it not from the real estate side or from the side of view of the person owning that business. This also is a good clause built in your lease if you can get it in there.

The next category we're talking about here, we're talking about parties. We're talking about parties to the transaction, and the first thing you're going to run into is a security deposit. Now, when you're going through these tapes, I want you to realize we have people that are going through this that are buyers, we have brokers, we also have sellers. So, as I start to go through this area, I'm going to change hats from time to time.

In this area here, the first thing we're looking for is a security deposit. If you're coming in from the buyer's standpoint where you the agent representing the buyer, what you'd like to do if you have a large security deposit as a seller is do financing. Later on in this program, as you start to think about it and you wonder how do we find out about this, you're going to find out about going into the balance sheet as soon as possible you're going to find that you can find out what deposits the owner of the business has put out, and it could be a security deposit on lease which we're talking about here, but it also could be a security deposit on the utilities. This is especially true on newer businesses or businesses in trouble. As businesses do well, most of the security deposits are refunded. Those are utilities.

In this area, we're talking about a lease and most often you're going to find the security deposits on leases are not refunded. It might be $5-$10-$15-$20,000 we're talking about. So, we try to get the owner to add to the financing over 10-15-20 year period.

If the owner balks at this, you'll then sidestep, ask the owner why, and he'll say, "Gosh, I don't want to finance that over that much time." We then will ask him for a side promissory note for maybe only five years to pay it over that period of time, and usually they say yes. You have to remember if you want to have the seller finance these deposits, you have to do it in the beginning. If you do it at the end, the owner will have spent this money in his or her own mind. In the beginning they forgot about the deposit, so it's easy to get them to negotiate this.

Now, for those of you representing the seller, or those of you who are going to be sellers of businesses, what do we want to do on our deposits? Naturally, we want all cash. What is the reality of it? We usually find that we end up somewhere between the two things we talked about – some financing, some cash.

The next thing you're going to run into you're going to need on a lease or the first and last two months rent in advanced, and again, this is about the maximum you run into. Sometimes I want four months rent, but it normally is three months rent.

If you're coming from the buyer's standpoint, you want to provide yourself with some financing. The thing you have to realize is it is possible through negotiation with the seller right in the beginning to get them to go along with the first month's rent and maybe one of the last two, which means they're financing one of them for you which is fine. Once I've gotten them to agree with that, what I'd like to get it down to is what? I'd like to get it down to the point where I'm just putting up the first month's rent which basically you're going to find able to do out of the cash flow of the business. So, that's pretty good.

Now, taking it from the other side again, I just want to mention if you happen to be the seller of the business naturally you want what? You want everything back. You want the first and last two months. It also gives you security especially if you're going to remain on the lease because as we get into this later, you're going to find that you are the leasee and in most cases you're going to end up as a leasee and the next person buying it from you is going to end up as a sublease.

One of the things we should start telling you about right now especially if you're selling a business, you're going to find in most cases in this country, you're not going to get off the lease. Why? Because the owner of the real estate would like to keep you on and then allow you to sublet to the next person. That way they have two people to go after if somebody doesn't make the payments. So, you better keep that in mind when you sell a business because you may get stuck.

What I normally do when I'm doing something like this, I will have the owner the subletee make the payments directly to me, and then I make the payments to the other person. Incidentally, this is basically a sandwich lease and I do this to cover my expense. I will usually charge the person under me more of a lease payment than actually I have to pay. Why do I do this? To cover my risks, and the other area is let's face it I'm in business to make a profit, and if I can make a profit on a lease also, I'll do that.

The next category terms – as you start to think about terms, again we're talking about the terms of the lease, and as you get involved there's two areas that you have to think about. Number one is the option to renew because when you go out in the next couple of weeks and talk to different business owners, they're going to say, "I have a five year old lease, and I have two five year options." Now, that's great. In certain businesses, you're going to want long options. You're going to want a long-term in that business, but again you may want some flexibility because if you're in it for 15 years with four 20 year options, what you're going to find is you're tied up for long periods of time, and you're going to find areas do change and although you're going to be very nervous about the lease being very short or the lease not being for a lifetime.

You have to realize the area that you're going to be in basically may fall apart. It will fall apart, and you're going to find that you may want to move down the street. You may want to move across town, and although most of you have this great fear about moving your business, in most businesses the movement doesn't hurt your business at all – in manufacturing, in distributorships, and service businesses. Now, in some retail business it might hurt you, but you're going to find you're not going to be moving that far and in most cases you may end up paying more rent as you negotiate a new lease. But, say you're moving from a downtown area in retail and you're moving into a regional mall. You're paying a little more, but you're going to find in paying more and moving your location, you're going to have a better location, more foot traffic, and you're going to find that although you're paying more your profits going to go up substantially which means the additional profit share is going to justify that move or that new location.

What you should do is not going to happen now. Also, if you're working as a buyer and you're in there negotiating with a seller to get a financing and you get hung up on the fact that the lease only has five years to go and you're trying to get 20 year financing, you're not going to get it because then you're going to make this seller worry about because you don't want to think terminally. Even if the lease only has so many years to go, you don't dive the business into the ground which is what a lot of small business owners do. You have to realize you have a five year lease, and you're going to renegotiate it and you're going to renew it, and you're going to move to other areas, and you're going to keep moving. It is not the end of the line when the lease runs out. In fact, of all the years I've been in this teaching for over 10 years now, we've only had it come back a couple of times where people had a psychological problem, and once you get over that it's not something you worry about. It's like worrying about a planet going out of orbit and crashing into the Earth. It's possible, but why do you worry about crazy things like that.

The next thing is an agreement to agree because on most options to renew – not most of them – we have found the last couple of years over 50 percent of them we have a problem. Why? Because the person starting the person wrote this crazy book on how to start a business and it said to get an option to renew. It doesn't tell them what the detail is. It doesn't tell him in the books that the option to renew has to spell out all the details of the new contract, and what happens is the owner of the real estate sits down with their attorney and says, "Look, why don't you give them a 47c." There's a 47c. It says, "The owner of the real estate and the owner of the business at the end of the five or ten year period will sit down and discuss a new contract or a new lease." That's not an agreement. We call that an agreement to agree, and what you're going to find is although you think or the seller of the business thinks that he or she has a legitimate option to renew, there is no option to renew. So, make sure you check those in detail and don't assume anything.

The next category is percentage basis. I read many conflicting things on this, and again I just read an article recently and it had to do with leasing, and this person was saying what you should do is go after the lease that is based on the cost of living index. I don't know who wrote that article, but they obviously are the college professor type because that is not the reality of being out in the business world today because what you're going to find in the business world even though you're reading things to the contrary, I'd suggest after you read the book check with the average business owner and find out what the real way to go is because here's a problem.

First of all, let's talk about percentage leases and you're going to find that they're going to say the percentage that you're going to pay on a restaurant might be six, seven or either percent of sales. In a clothing store, it might be something different, and there are standards that are established. It's almost like price fixing. If you go to your library there are many books out there that have to do with leasing and in there they will spell out the different percentages that are standards in different areas of the United States, and you're going to find that you're going to be generally in that category. For those of you who are trying to find out what you can charge, that's another guide that you can use, and it will give you a fix on it.

Now, a percentage lease is not bad. I like percentage leases very well because I don't like the other that we're about to talk about. Why? Because on a percentage lease, say I was paying five percent – if I was paying five percent on that lease and we had an inflationary period, I would normally raise my prices a certain percentage, and what happens is my rent would go up, but that's fine. The owner of the real estate then is sharing based on the same thing, and if I am a good business person raising my rates and prices at a rate equal to or greater than the inflation rate, then the owner of the real estate is being reimbursed at the same level.

Now, the next category we're going to run into here is the cost of living adjustment which is another method they use for figuring out how they're going to raise your rent in the future or get more money out of you. And, one of the things is a thing called the lost cost of living adjustments, and price indexes, and what you're going to find is they base it on that or base it on a certain year 1967 or whatever, and what it will say is based on the standard you had on the year you went in as the cost of living index goes up each year or the price index whatever index you're using, you're going to find that they raise the rate that you have, the rent that you're paying, or the lease payments you're paying.

The only thing bad about that is the cost of living index has a lot of phony stuff in it. It was based on the increase in housing in the last few years, and what we have here is a problem and you're going to find that in this index although the inflation rate maybe five percent, you're going to find that this cost of living index goes up at a rate faster than that which means that you end up getting gouged on it because of the stupid cost of living index.

Now, the government has been in the process of changing this, and changing some of the information they base this on. Again, at the date of the recording of this tape, the government still hadn't released it, and the basic problem that we have is the new cost of living index is going to be a lot fairer, but the problem is there are a lot of government people or people on retirement that have their increases in the amount they received based on the cost of living index. And, over the last few years one of the things that they had gotten and I don't mean to be political here, they have gotten raises in their retirement and other things that are in excess of what they're supposed to be getting. As a taxpayer, I think you're going to understand why I get a little upset, but you're going to find that because of that also politically, they're having a hard time putting it in. So, keep checking to find out when they're going to put it in. In the mean time, what I suggest you do is go to a percentage lease.

Control of conduct – many business owners find that as they get involved in business, they find themselves in violation of the lease and what happens is you read the lease and you assume things. As you find things that are contrary to what the lease says like control of conduct, the use of the premises, the type of business you have, the kind of merchandise. Quite often when the lease was signed five or ten years ago, and the person that owns that business now has changed various things, has not gone back to change the lease, and the owner of the real estate normally doesn't say anything. They've gotten verbal approval. It's now ten years down the stream, a lot of things have changed, and you come in as a new owner.

Now, the thing you have to realize is I'm suggesting that you ought to do this. You should go in and have the lease adjusted or get a variance from the owner of the real estate, and if you're going to do this, do it before you take over the business. If you don't do this, you'll get a notice after you take over and it will say, "You're in violation of the lease. You have 30 days to leave." Whatever your state law states, and what you're going to find is they really don't want to kick you out. You've been paying your rent on time or the former owner has. What they'd like to do is take that rent you're paying or that lease payment of $1,000 a month, have you sign a new lease and have you pay $2,000 a month.

So, when you do find these things, I suggest you go into the owner of the real estate and change and negotiate these things before you take over. If you don't, you're going to be sorry, and that is not based on reading a book. That's based on personal handled experience.

The next thing you have is damage or destruction. On total destruction may either party terminate? And, is there a partial termination or destruction clause? Well, the thing you have to realize is, the basic thing I want to say is if you're the person buying the business and you're the leasee, does that clause apply equally to you and to the owner of the real estate? Or do you find that they're able to terminate the lease if on little stick is missing, whereas you have to 110 percent destruction? Again, I'm exaggerating a little there, but when you start to read these leases, you will not believe what some of these have to say.

Number one, they were written by the owner of the real estate or their attorney, and you're also going to find the poor person going in to start that business didn't check them out, didn't know what they were doing, and they certainly weren't going to spend any money on an attorney because they would've wasted money there. And, it's foolish because for the amount they would've spent on an attorney, it's going to cost them 20 times as much every year of that lease which means you haven't saved a cent. What you've done is cost yourself money. How do I know about that? I used to go the wrong way many years ago, and after it cost me a lot of money, I decided to use the attorney. It's the best way to go.

The next thing is condemnation. Does the lease terminate if all or part of the parking area is taken? And, although many come to me and say, "Well, gosh, we don't really have parking. We have valet parking or we have special permits." The thing that's going to kill you in business especially where you have a retail type operation or other area where you have parking, if you have a temporary fix keeping in mind that our purpose business is you and your family or me and my family to stay in business ten, 15, 20, 30, 40 years. Eventually, I just want to tell you, everytime the parking problem is going to come in and kill you. You're going to find the parking problem is going to come in and eventually sink your business. So, you better make sure you have it solved.

The problem we're talking about here is condemnation, and suppose you have a business and you have 40 parking spaces, and supposedly because of the road widening or other types of condemnation, you lose have the parking spaces. It influences your business. You better realize, you better make sure that there's a termination clause in here because this is a bigger problem than we have found than the damage or destruction. Condemnation of this type – road widening, problems, change of zoning – have goofed up an awful lot of business owners more than the section on damage or destruction. So, please be careful.

The option to purchase – check to see if the option is still valid. Again, many of you read those books on how to start a business for under so many dollars, and the option to purchase is never spelled out in those little Mickey Mouse books, and so what I'm suggesting to you is on the option to purchase, is read it to see what it has to say, and you're going to find in most cases it said that at the end of the lease or sometime during the lease period, the owner of the real estate – the lessor – and the owner of the business – the leasee – will sit down and discuss and option.

You have to have it spelled out in detail. How are you going to purchase it? Will I finance? And, you have to have it spelled out ahead of time. Now, if you're going in behind somebody else that owns the business, and the option to purchase is necessary, what I suggest you do is sit down with the owner of the real estate before you take over the business, and negotiate it. You're going to find owners of real estate are just as nice as you are. In fact, many of the owners of real estate also own businesses. So, go and talk to them, but do it before you take over or before your client takes over.

The leasee's fixtures right to removal – in this area, we have two different sides because if you'll check with the attorney especially on the east coast, we have probably more case law in the area of fixtures and leaseholder improvements than in any other area, and again what is the difference. Fixtures mostly in the east and the Midwest we find people calling them fixtures. On the west coast, Midwest and west, we're calling them leasehold improvements or calling them leasehold expenses. What's the difference? Not much. The basic thing we're talking about here is whether you're talking about fixtures or whatever, we're talking about those items that we as business owners attach to the wall. Either they're leaning against the wall. They're screwed to the wall. They're nailed to the wall. They're fastened to the floor.

Whatever it happens to be, and there are state laws that apply in this area, but the main thing is the lease will spell out what the owner of the real estate wants or what the leasee or the lessor have agreed to. And, what you're going to find is that it may say that you can't remove anything, and what you're going to find is your lease runs out in two months, you have $400,000 in fixture or leasehold improvements. You can't remove those and take those with you. You're going to find in most cases you have to leave those there.

So, number one when you're buying a business, you better make sure about that. I mean why do you want to buy them? Why don't you just rent those from the former owner for a couple of months until you move someplace else, because you're not going to have those. You're buying something that doesn't exist. It exists but you're not going to have it in a few months. That's something that stays with the owner of the real estate.

Now, the other thing is you better realize as you read the lease or your attorney reads the lease, there's another clause that you're going to run into occasionally, and what it's going to say is the good news is you take it with you. The bad news is you have to remove it and in some cases, you may be in a regional center where the person that started that business had to put in the concrete floor, the floor, all the walls, the heating, the air condition and the johns. And, although leasehold improvements or fixtures are worth $100,000 today, you say, "Boy, that's great. I can those with me." You're going to find it's going to cost you one million dollars to remove them. So, please, either you or your attorney would you read these, and make sure that you haven't misread this. Why?

This could end up destroying you and your business. It's not something you read about in the little books.

Hours of business – another area that very few people think about, and the reason I'm so hung up on this is I've been involved in a lot of businesses over the years and a lot of my friends have, and a lot of the graduates of our programs where they've been hurt by hours of business because you're going to find if you don't have standard hours of business in your center, your strip center, your mall, and if the management isn't strong and doesn't enforce it, you're going to find that you're going to end up being boycotted by the customers and the reason for this is even though you open at nine o'clock every morning, and close at six o'clock every night and you're good about it. You do it seven days a week or six days a week or five. All the people around you are artsy craftsy type people, and you're going to find that they sort of open and close whenever they feel like it. As other people come to the center where you're located and find the other people are not consistent, they're going to end up not going to visit any business in the area including yours. Again, on this tape I am not going to recite these, but if you look in your area. Go around and visit a few centers and you'll find if you hit ten of them, there's probably going to be two or three of them that have the problem. Talk to the owners, and they're going to tell you the problems they have because of the business hours. What you want is a strong operation. You're going to want a management group within that center or within those buildings or in that area that enforces those rules, or maybe you're going to have to if you have a number of buildings, you're going to have to put together a merchant's association to try to force everybody through an association and talk to them about the benefits of all staying open the same number of hours and being consistent because consistency is the key in business today – consistency.

We start to talk about the next category here which is the right to sell the lease. The first thing we're asking is it valid without the leassor's written agreement? And, again usually will not release the leasee from liability. The first thing is it valid without the agreement of the person who owns the real estate. In other words, will they let you the owner of the business and the leasee off the lease. And, that's not going to happen very often. You're going to find real estate that people want to keep you on the lease because that gives them access to you as the leasee. The next party then coming on the lease, the person you sell the business to will be the subleasee.

Again, the thing we're saying is it valid without the leasor's written agreement. You're going to find write after this section, we've included a lot of information here that has to do with a recent court ruling because the recent court ruling if you'll just look at this section holds that a leasor can not unreasonably withhold his consent to the transfer of commercial lease by the leassee. Even though the lease states the leasor's consent is necessary for a transfer and does not provide that the leasor can not reasonably withhold such consent.

Where we are on this right now is we have the two parties, we had Cohen and Retton go to court a couple of years ago, and what happened is the person that owned the business had not done well during the transaction because the person that owned the real estate held back the approval. And, even though the person that owned the business did not win at the first level, when he went to the California Court of Appeals, the California Court of Appeals then decided in 1983 that you could not arbitrarily withhold approval.

Now, at the present time, there's a chance that this may also go to the California Supreme Court, and I've talked to my different attorneys on this in the last few months, and they've told me that they're feeling is that the courts will probably not change the ruling. So, this may stand.

Now, for those of you who are not from states like California, what we suggest you do is go to your attorney and have them refer to this ruling if the owner of the real estate does decide to arbitrarily withhold approval. And, again you can quote this. Why do we put all this information in here for you? Well, you can use this is you're able to read legaleeze. If you're not able to read legaleeze, what I suggest you do is make a copy of this and take it to your attorney and have your attorney do some research on it. Again, is it going to be important? Yes, because it has come up quite a bit.

The next thing we have now as we turn the page, is we're going to be talking about two other types of leases. We're going to talk about the sign lease, and we're going to talk about the equipment lease, and the thing that's really interesting is we talked about the fact that you're probably not going to get off of the building lease if you happen to be the owner of the business, but it changes a little when you get involved in sign lease and the equipment lease because you're going to find on the sign lease, you're going to find they will let you off. They will let somebody else assume the lease most of the time.

You're going to find that the maintenance, insurance, taxes are usually paid by the leassor, again the sign company. You're going to find there might be a right to purchase, and again, you're going to be making payments and you're going to find at the end of the period depending on the sign company and the state you happen to be in or the tax court area, they're going to have different rules as to how much of the money will apply to the purchase price and how much you have to then add at the end.

The other thing I want to warn you on, if you do end up converting a signed lease to a purchase, remember to have a maintenance contract in addition or you're going to find your costs on the side are going to go out of sight.

You'll get the feeling when you're leasing a sign that the sign doesn't really belong to you. It is a lease because the sign company ends up doing everything as if they owned it. Now, the reason that I mention this now as we go to the next thing we're covering right here the equipment lease, you're going to get a feeling when you compare the equipment lease to a sign lease. The equipment lease is going to be more of an ownership thing. Why? The maintenance, insurance, and utilities are usually paid by the leasee – you the business owner, and again, there could be a purchase clause built in which means that at the end of the period you can then apply a certain percent of your lease payment to the purchase price and add a few dollars or whatever it happens to be and end up owning the equipment and that is in most leases. If it isn't, ask them about it and they'll probably put it in for you.

The key thing to keep in mind though is that when you're looking at an equipment lease, you're going to get a feeling that you really owning it and it's another form of financing, and yes that's true. It's just another form of financing even though it's called a lease and it follows the terms as a sign lease, you're going to get the feeling it's a little different. Again, as I said before in the sign lease, you're going to find also on the equipment lease when somebody else comes along and wants to buy your business, you're going to find it's relatively easy to have this person assume or take over the lease and take your position.

LESSON 11

This is Section 11, and what we're going to be talking about basically is our Cash Flow sheet or cash flow section. This one right here, what we're going to be doing is we're going to be going through the Profit and Loss Statement, pulling the information off this to find out what our net profit is.

In addition to looking at the net profit that we have on the Profit and Loss Statement, we're going to build back in the different perks and benefits that the owner's taken out keeping in mind that when you start to look at these, on the first side, we're going to start to take it from the seller's standpoint and analyze the Profit and Loss statement, find out how much money is available to pay the debt service or pay the loans, and as we flip over the page, you're going to find out we're going to convert it to the buyer's side.

So, it enables us on the sheet very simply with this chart to analyze the profit and loss, add items back in, find out how much money we have available in the company that we're buying or selling or whatever, and back out the payments, consider the tax ramifications and look at it from the buyer's side. So, we're converting it from seller to buyer side.

Now, if you're going through this section first, what I suggest you do is go back and before you cover this section, do go back to the section on Profit and Loss statement. If you haven't reviewed it recently, I'd go back and look at that section first. I also would go back to the section on pricing where we talked about this because there's additional information in the pricing section, and then go to this.

Now, many, many years ago, a person, on my staff of a company where I bought companies for my own account, developed a line chart like this. He was an engineering type person, and again it was a very simple form. It didn't have a lot of information on it, and although we sent forms out like that to a lot of people we were working with and used it in our short programs and our regular seminar, we never used the other form because we didn't think it was important enough or good enough to use to help people that were trying to crawl along to buy or start a business.

Then a couple of years ago, we finally sat down and developed one that we felt would help people that were knowledgeable or not knowledgeable to understand where they were going, what they were getting in business as a buyer, as a seller to understand where they were going selling, and also to see what the buyer was going to be looking like because as a buyer you want to know what your cash flow is and how everything works out dollar wise. In other words, that you have enough left over. That the financing can work.

From a seller's standpoint, you'd like to know this also so you can make sure the person buying it if you're carrying by financing, can make the payments and do it safely and have a number of dollars of cash left. So, it has a lot of benefits.

It also helps us and you because what happens is if you just use these sheets and use them faithfully, you're going to find it's going to kill a lot of transactions that you would normally work on as buyer-seller, and all it's going to do is save you a lot of money. It's going to save you from failure.

Over the years I've educated a lot of people and the biggest problem I've had is trying to get people to follow what we teach, and what I've done in my frustration is I've gone back to the forms and controls we built in or we teach hoping that you'll follow them. Why do we do it that way? If I can't get you to listen to me then in the forms and the controls that I set up for you to use in buying and starting a business, I try to build the little Hamel voice in there to keep reminding you that you don't want to do this, or you're going on the wrong path because I can't be there with you every minute to guide you.

Now, on the right hand corner on 11-1, we have a price, and what we find here is the owner wants $400,000 for this company. He wants $100,000 down, and again it's a standard in the United States. I don't know why, but about 25% down is a normal on this guy's business. You're going to find the owner, under terms, will go 20 years, and he wants ten percent. In other words, he wants $100,000 down, and he then will finance the rest $300,000 over a period of 20 years at ten percent interest.

Now, we also notice that the cash flow PNL was from January 1, 198x, and that's right in the middle of the sheet, until December 31st, 198x because we want to know what the years is. You're also going to find you may make this up for a couple of years to see what it looks like. You may make it for the last three years to see what the cash flow would've looked like with you in there, and maybe you're going to project ahead as to what it's going to look like. Maybe your sales are going to stay constant, go down or go up. So, it gives you a chance to do a lot of things, and again this is why we call it a workshop.

Let's start on the first part here and start on the left hand corner, the upper left hand side, and you're going to find we have a thing called sales income. Now, sales income as you look at the profit and loss statement, it would say it makes $500,000 a year, not makes has sales of $500,000. So, last year we took in $500,000. So, we put that on the first line.

Now, on the second line, we're going to do a thing called subtracting. We're going to take the cost of sales and subtract it, and you've done this on the profit and loss and the examples that we've given you, and you also have done this in pricing. So, we have sales minus cost of sales gives us what over to the right? Looking at the line chart, $300,000, and in the beginning it's going to take you a while to get used to using this form, but once you start to use it for a while, you're going to find it's going to become very simple and you're also going to find it simplifies your explanation with a buyer, with a seller, with a broker. It also when you go to the bank or a lending institution borrowing money, they can understand this and once they see this you're going find they start using they same type form. Why? Because it's so simple and it spells the whole thing out.

It also enables you to base the purchase of the business or financing on what it really makes, and we're not basing it then on what the Profit and Loss statement shows because we know the Profit and Loss does not reflect what it really makes.

So, we have a gross profit of $300,000. If you'll then go down to the other section down about two inches from the top, you can see on the first part of the line it's talking about manager's salary, and we find the manager then is being paid $30,000 a year. We also have a little thing there a question to ask you. Is there going to be an increase? In other words, in buying it or you going to have to pay an increase.

Now, as you look at this, also keep in mind on this left hand side, we're looking at it from what? From the seller's standpoint. So, this is a seller's analysis from a seller looking at it or the buyer analyzing where he or she is starting. In other words, this is what the seller is showing you. We're going to adjust it a little to find out what we have and then we're going to convert it back to the buyer's side. So, the buyer can find out as he or she goes into that business, what he or she is going to have.

The next thing you have is the rent, $10,000. Again, the reason we isolate that, we've talked about this in other tapes, is the fact that lot of times the real estate is owned by the owner of the business, and you're in there buying it you decide not to take over that real estate at this time. Maybe you have an option to purchase. What you end up doing then a lot of times is to forget to build back in the rent. Now, as the other owner was making X number $100,000 a year, and now you're going to find that you have forgotten to make the adjustment because the other owner only showed that figure because they weren't paying rent. What you have to do is make the adjustment. I just want to remind you again. In this example, we don't have a problem because what happens is the owner is paying rent, $10,000 for another person.

Other expense, the next line down there, is nothing but the area to make the numbers add up. Why? Because we're trying to isolate the manager's salary, so that you know this is an example that the person analyzing it pushed back in all the owner's perks and subtracted out expenses, and as you subtract these from the gross profit up above of $300,000, what do we end up with? We end up with total expenses of $250. if we were just to subtract those now because total expenses are $250, what would our profit show? What would the profit and loss show? Yeah, it would show a $50,000, and wed go out to buy the business based on $50,000, and again if you look over the debts you're going to have, it wouldn't look very good. This would be a dog, okay, because it wouldn't show.

So, let's start analyzing the rest of this and see what we have here. So, let's go right down the line a little under the $250,000 expenses and start to add back in or subtract other items to show us what the profit really is. First of all, we could have other income. In this example, we did, and we'd either build it back it in.

Now, we're going to add back in depreciation or ACRS. Now, in pricing, we were adding back in depreciation for a reason that had to do with the fact that we're going to determine what the true wasting of assets or the return we had to pay ourselves in pricing. In this example here, the reason we're building it back in is we're going to build it back in from the seller's standpoint because later what we're going to do is we're going to adjust is to find out what the new owner's going to do – the buyer.

In this example right here, you have depreciation of $15,000 being taken by the seller and you don't have to turn the page now, but you're going to find as we get into the other part of this, you're going to find the buyer in working with the CPA have found that their new depreciation schedule or ACRS is going to be about $50,000. So, what we're doing is pushing it back in because that's what the seller is doing. The buyer is going to take it from a different side. So, we push that back in.

The next thing is the interest they're talking about because what we're going to do is build back in the interest here that this seller's been paying because we want to have this free and clear. In other words, this is a net profit on a all cash sale, no assumption.

What we're going to do later on the front part of this sheet, we're then going to after we find what our profit is free and clear, we're then going to back out all the different loans we have – the loans that exist, and also any new loans you have. We're doing it to simplify and make it easier for you to analyze.

You're going to find as you go below this the seller's perks or benefits have come to about $50,000. For those of you that don't remember, we're talking about perks being perquisites, and these are basically things at owners run for the business – some legitimate, some not legitimate. The thing that I want to warn you on as you're putting this down, I want to look at the bottom the sheet that said, "Note: All information is from sources deemed reliable, but is not guaranteed by agent. We use this in our brokerage from. The package is subject to price change, correction, error, omission, prior sale and withdrawal." Why do we put all these disclaimers in there? Because we have not gone in as CPAs generally to verify the books on a full-blown audit, and since we're using information that's been given to us and sometimes it can be bad, what we're trying to tell you is now you have basic information. As you buy this business you're going to have to have your CPA go in before you close and before you take over, and have your CPA check the books in detail to make sure the information is as represented by the seller.

Is it often not as represented? Yes. That's why we have these checks.

As we're here in this business, we don't have this seller taking a draw. The seller's only overseeing the business in this example, and the manager's being paid $30,000. So, we don't have that problem.

Travel and transportation – we have $8,000 of transportation costs and travel costs that are excessive. Again, some of them are things that are legitimate write-offs, some of these things may not be as we discussed in the area on our profit and loss statements.

We had entertainment of $20,000. This was a company that did a lot of entertaining, and as we looked at it we found that $12,000 was excessive. Again, a lot of these things you're going to be digging out. In other areas, if owners have sold businesses before, they'll give you a list of all these things. Why? They're trying to show you the additional items of profit if you're a buyer because it increases the value. It also increases the amount of money that they as sellers get. Again, sometimes they're given to you verbally, but it is in the seller's best interest to give you the information. It is then up to you the buyer to verify it. I want to repeat – verify it, and verify it again.

The next thing is pension and profit sharing, and the owner of this business has been taking out pension and profit sharing from this company as their share. Incidentally, beware of pension and profit sharing because a lot of times the number will be a lot larger and you include it here, and it represents the pension and profit sharing for everyone. You only put the pension and profit sharing here that relates to whom? The owner of the business or owners.

The next thing is insurance, and this is the insurance, again, just like the example we had in the profit and loss, it comes up quite often, where we have excessive insurance being taken as expense. Now, keep in mind one thing we've mentioned before and that is when owners own small businesses and there is Mickey Mouse going on, there's usually Mickey Mouse going on in skimming. They don't run the money through the books.

As a business starts to get larger, we find on the average, it doesn't happen as often. It's not because the people are more honest. What it means is you have four or five people or three or four keeping the books, and it's very difficult for them to play these games. What owners do is Mickey Mouse or play games with the expenses.

Here we have seller perks or benefits, and again, years ago we really didn't want to put this in. We didn't want to develop our pricing sheet the way we did because what we were doing was we're leaving a lot of people open to exposure to Internal Revenue, but the thing is on one hand we have a problem, how am I going to assist people in buying businesses and not get ripped-off if we don't lay all the cards on the table. If it does happen because of the forms we've developed that the people that own these businesses have to expose the fact that they've been ripping off, I can just say one thing, "IRS, how bout them?"

Why do I feel that way? I pay a lot more taxes every year because people in business are continually Mickey Mousing, and what I'd like to tell you, again restate what I talked about before in the tapes – why don't you consider getting a CPA, go the legitimate route on write-offs and you're not going to have to Mickey Mouse. The other thing you're going to find most of the time, you're going to have more write-offs legitimately than all the Mickey Mouse things you're going to do, and IRS will be much happier. We can get them off our back.

Now, as you start to analyze this and take the $50,000 that you have left after you subtract the expenses from the profit and add back in all these other items, if we haven't made a math mistake here, the net profit should come to $125,000, and on the line it says $125,000 which is a net profit on an all cash sale.

Now, you're at the point where you say, "Okay, where do we go now?" Well, you now have $125,000 to work with if you happen to be the buyer, or if you're the seller that's going to be available to the buyer of this business. We're now going to subtract the payments because we like to know what the cash flow is going to be after debt service. Again, you're going to have to become familiar with the terms. A lot of people think of cash flow as bottom line. Well, we're not exactly at the bottom line yet. It's cash flow after debt service. That's off to the right here, and you'll see after we pay the loan out it's $90,259. How do we arrive at this?

In the middle of the sheet just below the net profit here as you go down to the middle section, you're going to find that we have different loans. It will say loan number one – debt service, loan number two, loan number three. For those of you getting into more of these, more than three loans, you may have to put a little trail around the bottom of the sheet. If you get to this, I have a feeling you're also making a mistake if you have that many loans out, but it will happen occasionally.

Okay, loan number one – under it says amount, $300,000 – ten percent interest rate or financing for 20 years. Where do we get that from? Well, the owner asked for 25 percent down. So, we're giving $100,000 down wherever we're getting it from, but we're still giving the $100,000 down, and the owner's going to finance $300,000 over a 20 year period. If you go just above loan number one, it says the total debt service per year is going to be $34,741. In other words, your payments over one year will come to $34,741.

Now, just off to the left, you'll find that we've split it up and again this is just in a rough manner, and since the interest is going to be ten percent and to keep this example simple, and the loan is $300,000, the first year let's assume it's going to be $30,000. If you wanted to be exact as engineers and go to the tables, you'll find you're going to have a little different figure, a little less than $30,000. But, just ballpark because we're trying to use this worksheet, use ten percent, and you're going to find it comes to $30,000 interest.

Again, if you look over to the left again, if we're paying $30,000 interest of the $34,000, how much of it is principle? How much is going to pay down the money we owe? $4,741. We'll need that on the other side.

Now, once we've subtracted the loan we're paying because our loan payments every year on the $300,000 loan will be $34,741, if we then subtract that from the net profit above, you're going to find off to the right the cash flow is how much? $90,259. Now, if there are additional loans on here, you can go out and back in any of these loans, or if you want to analyze this from different standpoints. We've now analyzed it with $100,000 down. It's then possible for you to go back later and take the same sheet and analyze it with nothing down to find out what you're return is or how it looks that way. So, you could take it from a lot of different angle, but just to make it simple, it's $100,000 down, and say it's your money, your assets. We'll come back and look at it from another standpoint in a short while.

Let's turn the page now, as you turn the page you're going to find, and flip it over, you'll find that we have a little arrow up at the top which said two on the other side, and the little two said that the cash flow after debt service from the previous page was how much? Remember the figure $90,259.

Now, as the next step, what we're going to do now is we're going to figure out what our income tax is going to be in the company we're buying so we can show the buyer how much money we're going to have left not only after they pay the loans which we already have because after loans you have $90,259, but how much will I have left now as I subtract my taxes because I want to now how much is going to be available for me to put in my pocket, what do I have?

So, we look at the net profit of $125,000, again going off to the left here. On the first line it says net profit $125,000. Where do we get that from? From the prior page. Okay, so we have $125,000. Now, this is a normal thing that we'd normally have to pay tax on, but let's subtract the things that are not going to be taxable.

First of all, any depreciation you have, ACRS, is not going to be taxable. So, as you subtract this from $125,000, we subtract the $45,000. Now, how much depreciation was the owner taking? Something less. I think I gave you the wrong number before. I think I said $50,000. I was looking at the perks, but the number here is $45,000.

So, what you do now is you subtract the $45,000 because the $45,000 will not be taxable. Now, you're going to find that this is different from the $15,000, but this is why we make the change.

Now, the next line you're going to find we're subtracting the buyer's perks. In this example here, we are assuming that the buyer is going to take the same perks and have the same write-offs that the seller had. Now, this is not always the case, and you're going to find as the seller sits down or the buyer sits down and talks to the seller, the buyer may decide to do things either cut back on the perks they're taking or add to them, and you're going to find that number can change.

In this example right here, the buyer, the person buying this business decided to leave the numbers the same. They decided to take the same perks. The next year, they may decide to change, to add or subtract, but this year we have the same.

The next area is the buyer's interest paid because we are also going to find that the amount we pay in interest is not taxable. So, we subtract the $30,000, and lo and behold in this example although we don't really talk about this in the total program, we happen to have a business that has no taxable income because of the write-offs. We've written off everything that would normally be taxable.

Now, we have zero taxable income, now there may be special laws that are going to require you to still pay tax, but based on just our rough analysis that we have here, we don't have to consider the taxes although there may be a few little things that come up under the law. So, we have taxable income zero, which means the cash flow bottom line is still $90,259 because we don't have taxes due next year or this year.

Now, keep in mind one thing, you're going to find in business there's many ways for you to sit down with your CPA or tax advisor and do some tax planning, and you're going to find for the first year that you may be able to minimize or get your taxes down to close to zero. Eventually, it catches up to you. You're going to find you're going to end up paying tax, but the key thing to keep in mind in the first couple of years, I keep trying to tell you there's nothing wrong with owning real estate or tax shelters. What I'd like you to do is go out and get involved in businesses and make a lot of money. Write-off as much as you can the first year or two legitimately, and then after that go after the tax shelter. Get the money first because if you don't, you end up with a tax loss carry forward. That's stupid. What you want is what? Money first, and then write-off, and you're also going to find that don't start spending all your time going after tax write-offs because you're going to find in the same amount of time that you go out looking for Mickey Mouse tax loopholes and things like that you could actually make more money by going out productively and earning more money in your business because for every hour you spend on tax cheating you could spend that hour productively on your business and make even more money after taxes. You've got to get this tax mentality out of your mind. That's for investments that don't make money. You're in a cash position. You shouldn't be goofing around with all these things. Let your CPA do it.

Now, we go down the bottom now, and we're going to start figuring out what the cash flow is. We're going to figure the return. Now, we've put up $100,000. If you wanted to figure the cash return and it's not on this sheet, your cash on cash, there'd be a $90,000 return on $100,000. So, what would your cash on cash return be? About 90 percent which is pretty darn good.

Now, if you take the cash flow here of $90,259 and where we have that number one bold you're going to find we're going to add back in the equity because we're going to have cash in pocket and then we're going to have equity build-up over four thousand some dollars. Now, we are not building up the appreciation of the business. I just want to tell you something, as you keep increasing the profit we have inflation, you're going to find in this country your business is going to go up in value. Not that you're going to make a lot of money every year, but you're going to find every year your business is going to appreciate as long as you're doing it properly, and you're going to find that although your business year, you're buying for $100,000 you're going to find in X number of years is going to be worth $200,000, and eventually a million dollars. Yes, it does go up in value even though we don't talk about it that much.

Now, with the total return comes to $95,000, that's the cash build up plus the equity, and that's the return on $100,000 and you're going to find your total return here is

95 percent. In fact, I want to tell you something when a lot of you come to me and tell me you have a 23 percent return, although that's good in the total marketplace, it means you're looking at the wrong type businesses. Most of the returns we run into are up in the category of 100 percent or more.

Now, let's go back to it, because I'm going to blow your mind with numbers, I love to do this on the tape because I know you're going to spend many hours especially you engineers or if you like to work with math. Let's go back to the other side now and without using another sheet of paper, let's just analyze this and this is simple, you don't have to note this down. Suppose we were to go out now on this business, and we don't want to put up the $100,000 we're back on 11-1. Instead of doing that, we're going to have loan number two here, and we're going to borrow the $100,000 from suppliers. Now, normally suppliers don't charge us interest and if you work it right, you're going to find that you don't have to repay it as long as you're doing business with them.

Well, if this happens to be the case here, how would this influence side one? Would the cash flow after debt service change? No, because what you're going to find is the cash flow after debt service will still be $90,259.

Now, let's flip the page over keeping in mind that we have now financed the business a hundred percent say using supplier financing or some other technique. That means the cash flow is still $90,259 bottom line after taxes, correct? Yes, it hasn't changed.

Now, let's go over to the other area because right now we have a $95,000 return on what investment? Aha! Zero. What is $95,000 divided by zero, and you're going to find your return is infinite, but being math people why don't we divide by one. Let's assume an investment of one dollar. In fact, what I'd like you to do is make sure in the transaction you put up one dollar or have your client put up a dollar. What is a $95,000 return on a one dollar investment as a percentage? As you sit there trying to figure it out, supposing the figure comes to $9,500,000 return. Suppose you missed a decimal point. Suppose you tell all the world you only got a $950,000 return. Suppose you miss another decimal point and say that your return was only $95,000 percent or $9,500 percent or $950 percent.

What I'm saying is when you figure this out, even if you miss a decimal point, the return is obscene and that's what I think is fantastic about owning a business. I love it.

LESSON 12

In LESSON 12, we'll be getting involved in the actual basically what you call a negotiation of the contract, actually making the offer to purchase, counteroffer and going through the period called escrow or closing, go through a thing called bulk sale, also filing a financing statement, and going through the different areas that basically are at the end of the transaction or for those of you who are brokers, you're basically in the middle. In other words, you've already put the information together. You've got the listing. You're now going to sell it to somebody.

So, we're going through the different purchase areas here, and as you look at the purchase document on page 12-1, I'm not going to take you through every area. What I'd like you to do is use this as a guide when you're drawing up a contract or if you're having an attorney draw up a letter of intent or some short document.

The thing I want to warn you on as you start putting a transaction together, I don't want to put down my attorney friends, but the thing you have to realize is if you bring the attorneys in too soon, your chance of putting a transaction goes down quite a bit. It's not that the attorneys don't do a good job. It's what we try to do is we try to get a basic agreement between buyer and seller in writing, which is three or four pages long or maybe five pages, and then later go to the attorney.

Now, again, the attorney can say, "Well, you should've come to me first." Well, you can go to the attorney. You can check with him, but if you start getting him in there monkeying around with it right in the beginning and the buyer has one and the seller has one, you're going to find your chance of ever putting a transaction becomes very small. So, what we do is we try to take the pressure off the back of the attorney by going through the standard things that we normally want agreement on which is the price, the terms, whether they're going to stay or not, the down payment, and these are things basically that is something that the buyer and seller agree to based on how they feel.

The attorneys, basically, should be protecting you in the other areas. The CPAs should be protecting you in the area of taxation. Getting back to the attorneys, they should be protecting you in the area that has to do with legal protection and not getting in the other area of saying, "Gosh it is not a high enough price. That is not enough of a down payment." And, although attorneys may be very bright in a lot of areas, I still have not met very many attorneys that know anything about pricing a business even though they profess and give their clients information in that area. The same thing with CPAs, and the problem is you put them in a position where they have to overprotect you. What you should be considering doing – again, it's up to you to decide – you should be considering using some short form agreement. Again, it could be a one-page letter of intent that your attorney could draw up and then further refine it, or do what we do here which is use a short form purchase agreement. You could either use a state document that is available in your state, or use our example here.

Incidentally, if you do use a state form, you're going to find it really doesn't cover enough, and we've looked at all of them. What we suggest you do then, is go through here and pick out the areas your state form doesn't cover and pull our paragraphs out and use them as addendums to the contract.

Now, you have to realize we're not trying to beat the attorneys out of anything, and also the contracts that we use and any agreements have been drawn up by attorneys. We pay attorneys for doing this over and over again. So, we're not beating them out of anything.

You're also going to find as we go through this later in this section, we're going to have the attorneys then come in as we have agreement on the short form, and the attorneys then will take the short form and expand it. We've also found if the attorneys find something blatantly wrong with what the agreement is, the agreement can still always be modified between buyer and seller by going back. But, the thing is we try to keep the attorneys and the other people out of the areas that basically is none of their business. Again, protecting the client is their business, but the thing is getting them out of areas that the really have no expertise in, but yet do make comments to their client. I know I'm going to get a lot of nasty letters from attorneys now.

The purchase agreement now – let's start going through it and let's start talking about the deposit. Many of you think that when you're putting up a deposit or earnest money or whatever you want to call it which is money to get the seller to pull the business of the market, you think a lot of money has to be put up. Well, it can be a token amount or what you can do is what we do most of the time. We use a promissory note. Where do you get promissory notes from? You can get them from the stationary store, and a promissory note you buy a pack of them, you'll have enough to buy businesses for your lifetime.

Now, a promissory note, what we normally do is we put up a promissory note as a down payment or earnest money, and on it we write that this money will be substituted by cash on or before the close, or we will then put up cash for this note after the offer is accepted. We don't like to put it up when it's accepted because things can still go wrong. What we'd rather have you do is put it up at some point in the transaction after everything's been verified, after all the contingencies have been lifted, even maybe after your CPA has checked the business out because if you don't do this, we end up with a problem in a business.

The other thing I want to warn you on, when you do run into a business, and you do have to put up cash, what we normally do is we'll open up two escrows or two neutral accounts. One will be on the business, and the other one will be set-up stating that this money as a down payment or a deposit will not be funded to the regular escrow or closing until the following conditions have been met because what happens, we find in most cases if here is misrepresentation most of it is on the part of the seller, and usually what the seller's trying to do is get money in their hand. They then end up misrepresenting which causes the buyer to back out, and the buyer then has trouble getting the money. Why? Because it's already in the hands of the seller.

So, we are usually trying to figure out some method whether we're representing the buyer or the seller to keep that money in a neutral account as long as possible, and the reason for it is when we do have the problems, it makes it a lot easier to pull the buyer and seller apart and undo the transaction. Now, again, we start talking about this promissory note. For those of you that have fantasies about the fact that sellers are not going to accept these notes. If the seller comes to you and said, if you need a recourse, and say to them, "Look, I don't want a promissory note. I want money." Well, when they come to me and ask for that, what I say to them basically is, "Look, if I have to take money out of accounts that I have that are interesting bearing or something like stock I'm going to have to pay tax on, and put it up on this transaction, how do I know it's going to go ahead? Now, if you insist I put it up, I will" But, since of most of the misrepresentation is on the part of the seller, I'd like you the seller to put up an equal or greater amount of money in an account, and have that account say that if this transaction does not go ahead because the seller has misrepresented, this money is given to the buyer. In all the years I've been doing this, everytime I bring this up as a thought to the seller, the seller then backs out and says the promissory note will be fine.

Incidentally, from a legal standpoint or from the attorney's standpoint, having a promissory note is not that bad. Why? It gives the seller access to all the assets of the buyer, not just the cash. It's an easy way to go. We do it all the time especially in the larger businesses.

The next thing and again, we're talking about the price and terms, assets, liabilities – when you get down to allocation in here, this is allocation based on a couple of things. First of all, there's a couple of different ways you can buy a company or sell a company, and if you're looking at the bottom of 12-1 and over to the first part of 12-2, you're going to find we have allocated. We have broken down the value of the business into it's basic parts. When you're talking to your CPA, you're going to find that maybe the buyer and seller have agreed to a price of $100,000. You now are going to break the price down into it's basic components to get tax benefits to buyer or tax benefits to seller.

Now, this is in a sole proprietorship you allocate, or if you're buying the assets and liabilities of a corporation. If you're buying the stock in a corporation, you're not going to be allocating on the offer to purchase. Why? All you're doing is buying the stock. You're just buying the stock. So, if you're buying assets and liabilities – to repeat – or if you're buying a sole proprietorship, you're going to find that you are able to do a thing called allocating, and as you sit down with your CPA he or she will break this down for you tax-wise. Again, you're going to have to have an agreement between buyer and seller in this.

The other thing we mentioned as you go into the paragraph under this allocation, it says, "An actual inventory shall be taken by buyer and seller at the time of closing, and adjustments if any shall be made at the completion of inventory. Any variation in access of a certain percentage between estimated and actual values for either the receivables, which is A, or the inventory, which is B, shall give the buyer the option to terminate the agreement." And, the reason we put that in there is sometimes in the transaction, the amount of inventory, or the accounts receivable, could vary so much that it could kill a transaction, and what we're doing now is giving the buyer the opportunity to spell out what variation they can live with. Again, don't come back and ask me what the amount is, ten percent of $100,000 is only $10,000 and you could possibly live with that, but if it were a million dollars and ten percent could you live with $100,000 variation if you used ten. So, what you're going to have to do is work this backwards and use your common sense, but you're going to find it's going to help you.

You're also going to find as you go through the agreement we have a number of things in here that discuss different areas – buyer's remorse and seller's remorse, and spell it out for you. So, read the different areas.

Now, keep in mind also, this document was developed a long time ago to protect both the buyer and the seller, and you're going to find if you happen to be a buyer you may not want to use all the paragraphs and the same thing from the standpoint if you're working from the seller's standpoint. You may find all the paragraphs may not apply to what you're trying to use. So, just don't blatantly or in total take the form and sign it and use it because you're going to find there's going to be a paragraph or two in there that are not to your benefit.

If you look at page 12-9, there's a thing called covenant not to compete. It's something that a lot of you asked me about, and this is the agreement not to compete. In this example right here, it's included as part of the original document. As you or your CPA check the law, you're going to find that this has to be a separate written document. So, as you get into the escrow closing period, whoever's handling the paperwork such as the attorney will have to draw up a separate document for the non-competition agreement.

But, basically, all the non-competition agreement says is the fact that the seller will not compete with the buyer for a radius of so many miles, and also for so many years. We find in certain parts of the United States, the non-competition agreement may not be valid. They may have – such as Montana – they may have a rule that states that you can only have non-competition within the county. Or in Honolulu, they don't allow the non-competition law from the standpoint of the legal side. The reason for that is if you set up a 50 mile non-competition in Honolulu, the person would probably have to go to Australia.

The thing you have to remember in the covenant not to compete or the non-competition is you have to keep it fair because you're going to find the courts are not going to allow you to set-up a non-competition agreement that will keep the buyer or the seller from every gaining employment or feeding their family. So, you're going to have to make sure it's fair.

You're also going to find out in the area of years, you're going to be able to write it off based on the number of years. So, if the non-competition agreement happens to be for a value of $100,000 and it's for a five year period, the buyer can write-off $20,000 a year. IRS then just tries to keep it inline by saying, "We would like you to have a non-competition agreement not go beyond your normal life." In other words, the insurance companies have put out actual tables based on that if you're at a certain age as a man or woman, you will probably live so many years based on their statistics. The government then uses this to make sure you don't go beyond that period. Again, I'm not trying to give you a complete definition. I just want you to understand that in this program.

As we finish this contract, basically what you're going to have is the buyer and seller are sitting down and they're negotiating. You're going to have things called counteroffers where the buyer's going to make an offer to the seller. The seller's not going to like certain things, and counteroffer back. By the time you're finished even though you're starting with a small document, you may end up with a couple of more pages as buyers or sellers want to make changes in the original document. Eventually, if you've done your homework, you'll get to the point where you do have agreement between buyer and seller.

Now, in the contract we just talked about here, I want you to realize there's one basic thing we've left out, and that's called the contingencies, and if you look at the next page we have here, you're going to find that we have a thing called contingencies. Now, contingencies are also known as weasel clauses, and again, please don't call them weasel clauses in the contract or the negotiation. You'll screw it up because you'll scare the seller. But, again, if you want a full disclosure, that's what they are.

Contingencies mean basically this contract is subject to the following things happening. An example here, the buyer's example – it says the purchase is subject to inspection and approval in writing of the books and records of the buyer, and what you have to realize here from a buyer's standpoint - you have to sign-off on these things.

I also want you to realize as a buyer, you don't have to go back and explain to the seller why you didn't like the books, and you don't have to explain to the seller that you didn't like page seven, eight, and nine in the journal. What you have to do is if you have checked the books and you don't like them, do not sign off and approve them. And, also beware – beware of people that write the contracts in reverse, and what they end up doing is they'll put it down, and again I can't quote it exactly, but it will say that you will have

– the buyer will have so many days to verify and check the books let's say ten days. If at the end of the ten day period, they have not notified the escrow in writing that they don't like the books, the contract will then assume that we are going forward.

In other words, if you don't go back as a buyer and tell them in writing that you didn't like it and spell out specifically what it was, that you have to go ahead with the contract. Do not get trapped into that.

Now, in all the years I've been working with people that have it that way, it's usually something that comes from the business broker's community, and again of all the times I've seen it, I have also found if I further check these brokerage firms, they also try to rip off people in other areas. Is that a rip-off? Yes, because what they're trying to do is rip you off in the negotiation.

The next thing is we say the purchase is subject to inspection and approval in writing of the equipment by the buyer. These give basically a buyer the agreement, and again if you're doing a good job as a buyer, you basically have gotten the seller to take the business of the market. You've gotten the seller to agree to certain things, and you then have a way out.

The thing you have to realize as you get involved in financing, if you have gotten the owner to carry back financing for 75 percent, and you hit the owner with a contingency that said, "This is subject to my borrowing 25 percent down and four million other dollars." What you're going to find is the seller is going to get very upset with you because even though the seller has said to you, "This is what I want. I would like to get 25 percent down and I will finance the other 75 percent over so many years." They get very uptight when they know you don't have the financing because basically what it is when a person comes in to a seller and the seller said to the buyer, "Do you have a financial statement?" and, small businesses like Mom and Pops or little start-ups, they're going to find they want the financial statement because they want to check your cash flow to make sure you can make the debt payments because the business won't have a lot of money or none.

When you get into the larger businesses over $50,000, most owners are not asking for a financial statement because they want to find out where the secondary source of repayment or how are you going to repay the money because the business you're buying can repay it and do it safely. What they're trying to find out in your financial statement is can they see on your financial statement where you're going to get the down payment from? Again, the basic thing you're looking at here is they want proof that you can come up with the money. Very few sellers really care where the money's coming from, but what they like to do is make sure you're not a tire kicker and they want to make sure that if you agree to give them 25 percent down, that you can deliver on it, and that's the key thing. I'm not going to say the other never exists, but that's the key thing they're looking for.

Now, what you're going to find is for those of you representing the sellers or if you are a seller listening to this, you have to realize we're teaching this from two sides, and what you should do is counteroffer because what happens is if a person buying the business comes in an offer that tells you that they want this subject to inspecting the books and there's no date on it, that means you can keep this thing open forever. So what you should do is consider counteroffering.

When they put down the purchase is subject to inspection and approval in writing, you should put down that you have to do it within ten days, or if they want to inspect the equipment, within three days. Again, I'm not recommending that this be the period, you should put something down. This enables you to cut them off and you have counteroffered. They then have to make that decision. If they haven't made that decision and signed off in that time, you don't have to go ahead with the contract.

Now, keep in mind, if an offer has been made and there's a counteroffer that said that you have to do it within ten days, and you're the buyer, and say your CPA has not had a chance to get finished in ten days, you still could go back to the seller and get the thing changed. Don't be afraid of that, but do spell out all the details.

Now what I'd like you to do now is we're going to turn to the backside, just flip the page over, and you're going to find now we're going to start talking about the escrow, the closing, the consummation of the transfer from buyer to seller. Now, as we're going to be taking this to a period now. We've got the buyer and seller to agree to terms. We've gotten the sign-off on it.

Now, before you do this, before you go out and start to open up an escrow or go through the closing period, or bringing attorneys into it, CPAs, I want you to realize I want you to get the financing done first. Now, I don't mean say I don't want you to hire the CPAs or the accountants or the attorneys on an ala carte basis to check contracts and do various things, but we normally do not bring them in to do the major billing and the major checking until after we've had all the basic things done. Why? Because too many things can still go wrong.

So, before you open up the escrow or start incurring a lot of expense, what I'd like you to consider doing is get the contingencies out of the way like number one, do you have a financing problem? Are you still having trouble with the down payment? Have you gotten approval from the bank? Have you worked with your suppliers? If you haven't done that, what I want you to do as soon as the thing is signed off before you commit yourself to spending money as a buyer, I want you to side step down the street and take care of your financing.

As soon as you take care of your financing then, come back and do the thing you called open up the escrow, sit down with the attorney, sit down with the CPA, but don't do it before you have all these things done. Why? Because if you don't do that, you'll end up committing yourself to a lot of money, and the transaction will not go ahead, and you'll have to waste that money, and again, knowing full well that you're going to have spend the same large amount of money on the next one. So, please do it in the right order. Take your time.

Now, once you've arranged whatever you have to arrange – financing or whatever – we then consider going to what we call the escrow or closing period, and if you look at the sheet it says, "The consummation of the transfer from seller to buyer." Again, the consummation – quite often we're using an attorney and we usually recommend using an attorney because they're also required to handle and expedite the legal work.

Now, again, we have over the years tried to work with banks, title companies and escrow companies, and although in some areas we do have exceptional ones we've worked with, we have found over the years that they don't do a good job in our area. They also tend to make comments about the legal part of the transaction or the tax part of it, or just say, "What kind of a Mickey Mouse deal is this?" And, what happens is we have a hard time keeping people that know nothing more than how to shuffle papers from giving legal advice, giving tax advice, and again we've just had bad experiences with them. If you've happened to have a good one, fantastic. In fact, we'd love it if you could come back and recommend them after you get down using them because having good people in this area to work with would be fantastic. But, we haven't found that over the years.

The next thing I want to talk about here is the actual purchase agreement because what we're talking about here on this page under B is where talking about the long form, and we're saying pages and pages of protection for buyer and seller and brokers. Do not be tempted to use a short form to carry through the full transaction.

Now, in the past have I seen things go through with a short form? Yes, I have. Have I also seen a lot of lawsuits because of that? Yes, I have. What I'd like you suggest you do is take your time and go the right way. It may be a little more expensive, but you're going to find that once the attorneys take the three words whether we have agreement between buyer and seller, and expand the three words out to 50, 500 whatever it happens to be, add a lot of other boilerplate which is just standard paragraphs, you're going to find that you're going to find fewer lawsuits. You're also going to find fewer buyers and sellers pulling out. Why? It's very easy in your mind to take three words of an agreement between you and the other party and twist them and say, "I can get out of this."

Once they get it up to many, many words, you're going to find that most people don't back out because the reality hits them right in the face when they sit down and read that long paragraph and say, "Oh, it isn't as I thought it was." Why? Because it's been spelled out with a lot of words, and although I don't like having to go to long contracts, I have found over the years you have to do it. You have to spend the money.

For those of you listening that are still thinking about, "Gosh, I'm not go through an attorney. I'm not going to use a CPA." Number one, every person in the transaction needs an attorney. Every person in the transaction needs a CPA that knows what they're doing. In fact, you're going to have to find an attorney and CPA that understand business. You're not looking for a divorce attorney. You want an attorney that has done this before a number of times. You want a CPA that knows how to check books. You're not looking for a CPA that has worked as a controller for a large corporation. You have to have somebody that can help. Just because they have a title, doesn't mean they have the experience or that they should be working in this area.

As we turn the page now, we start to get involved in the area that is very interesting. It's a thing called a bulk sale, and the bulk sale is broken into two divisions. The one that we have in the section here in the book is from the California Uniform Commercial Code, but you're going to find that it is very easy and very similar to the national, and let me explain it from a national and a state standpoint.

Many years ago, the Uniform Commercial Code was developed at the national level. What has happened since then as far as I know, all the states we have been in, they have adopted the Uniform Commercial Code. The only one that we have found that has been a little different has been the one in Louisiana, but over the years every state that we have worked in has had the Uniform Commercial Code.

What has happened is the states then have varied the Uniform Commercial Code that was set up at the national level, and set it up for their own level. The reason why we use California is most of the people that we work with are from the California area, and we also find that the Uniform Commercial Code in California is the best one to use in a teaching situation because the California area is the toughest one. California is the one that other one's normally follow, and that doesn't mean that California is the leader. What we find generally is that California leads in the area of fraud, and since I happen to be from the state I'm not criticizing another state.

Now, what we have here is we have Division Six of the California Commercial Code, bulk sale, and basically bulk sale is just posting in the newspaper of general circulation information that the business is being sold. And, what happens is it gives information to the creditors, unsecured creditors. In a few minutes we're going to cover a thing called the financing statement which shows how a creditor can put a lien on a business or remove it, whatever. They're secured. But, the thing is we also have a lot of unsecured creditors out there, and a bulk sale goes out to protect those people.

Also, for those of you who are buyers in the business, this is the only basic protection that you get when you take over that company. Why? Bulk sale, we don't have the normal protection that you have say in the area of real estate.

First of all, we're saying on a bulk sale used in California, it has to be recorded in the Office of the County Recorder in the county or counties in which the property's to be transferred at least 12 business days prior to the bulk transfer. Most states require that you give the information at the county level. The difference between California which tells you that you have 12 business days to the other areas is some of them will say seven days, some 14, some 20. So, find out from your state what it is.

Also, I want to warn you that as you get the information from your state, you better check it for another state because each state is basically different and also each state basically in December ends up changing various parts of the things. So, you're going to have to find out what it is today, and at the end of every year the first part of the next year, you're going to have to find out what changes have been made, and they do make a lot of changes.

B is one of the most important things and it said, "Published at least once in a newspaper of general circulation", and it also tells you how much ahead of time you have to do it, and again two things vary from state to state. Number one, how many times you have to publish. In California, it's only once. Other states it's two, three or four times. And, the other thing that varies is how many days ahead of time you have to do it, and you better make sure you follow both of those.

"Personally deliver or send by certified mail in this 12 days, a copy of this transfer" to whom? The county tax collector. Why? Over the years, many unscrupulous business owners have tried to beat the local, state and county people and federal out of taxes they owe. So, what did they do? You have to send notice to these people. Why? Because they'd like to collect the money.

I also put in there what a business day was because in the state of California, with a lot of holidays you might cut the bulk sale short by a couple of days and end up goofing up the buyer.

Okay, I'm not going to talk about the notice contains because you're going to find as you go down to publish this, say you happen to be the buyer, and it's your basic responsibility because it's protecting you. You have to go down and publish this, and when you go down to your local paper, you're going to find they have beautiful NCR snap out forms, and on it each one has a different color and as you sign it and fill it out, it gives the newspaper all the information that they need. It also tells you how much money you pay. You hand it to them. There's usually little arrows on it going to the next copies to tell you which copy goes to the county, which goes to the tax collector, and so on which is your copy. So, they've made it very easy today in the United States.

Also, don't be tempted to put these notices in little Mickey Mouse newspapers because if you do end up with a lawsuit you're going to end up that you may not win the case. So, what I suggest you do is follow the law. It was set up for certain purposes and don't go around it.

Now, in some states, you have to go through the bulk sale is protecting the buyer and the creditors, in other stats you have an option or some states only require certain businesses to do it. All I want to tell you is one thing, if you're going into a business and you want to protect yourself and you're a buyer, do not waive the bulk sale, and again, I don't happen to be an attorney and I'm not protecting you from a legal standpoint, but I have been in business many, many years now and all I can tell you is everytime I have seen a person violate this or try to take a shortcut and that's what most of you do – you say, "Hey I'm going to take a shortcut. Why go through the bulk sale? I can close sooner. I can take over sooner." Right, and you're going to get ripped-off sooner. So, what am I telling you? Fine, you're your own person, you can listen to your own attorney, but as a friend, I just want to tell you please use the bulk sale whenever possible because you're going to find it's going to help you out.

Now, what I've done in this section also, I have included all the other information that has to do with the California Code in this area, and the reason for that is some of you do need more detail. So, I have left the information in here for you, and I'm not going to cover it.

Now, what I'd like you to do now is in this section, I'd like to turn to the next important section here, and the section is on page 12-21, and it's called the financing statement. The financing statement, again, you're going to find this in the National Uniform Commercial Code. You're going to find the local one. It's Division Nine of the California Commercial Code, and again it's part of the National Commercial Code, and what we're doing now is we're going to have three different copies that we have available. We have the UCC-1, the UCC-2, and the UCC-3. These are all forms that have to do with placing liens on businesses.

Now, in real estate you have things called deeds of trust and you have mortgages. Again, these things basically are liens on real estate. In business, the only type lien we have is a thing called a financial statement and they are secured at the state level, at the Secretary of State. Now, in certain states, you're going to have to check this out because in some states you also have to record these at the county level. California, again, it's just at the state level at this time.

The first thing you have is the UCC-1 which is the financing statement and again it's effective for a period of five years from the date of filing and you better check on this because in the days before we got involved in education, most of the financing on business from banks or from owners was five years and less. As we start to expand it, you'll find most of our financing now is out in the 15-20 year category and beyond and you better worry about it from the seller's standpoint. Why? You're going to find at the end of the five year period this will be removed from the record which means there is no longer this lien on the business. Again, from a buyer's standpoint, you're not going to worry about it, but if you happen to be the seller, you better remind yourself every five years to go back and renew this or you're going to find the lien's removed and the buyer can then go out and rehawk whatever you have put the lien on because it doesn't have to be a lien on the business. It might be the lien on the equipment, the receivables or any other item in there. It might just be a lien that the plumber put on the business because you didn't pay your plumbing bill. It could be anything.

Now, if you want to see what the financing statement looks like, look at page 12-25 in this section. Again, for those of you from other states other than California, you're going to find that you can get them in your state or in California, any state, by going to a stationary store and you're going to find they have four or five copies, snap out NCR. You don't even need carbon paper, and they sell them very inexpensively in little packets, and you then can go out and file your financing statement. You can then put the lien on the business.

The next thing that we have is the UCC-2. It's on page 12-26 for those of you who want to see a copy of it, and we're doing a number of things here. The first thing we're using it for is continuation. A continuation statement may be filed by the secured party of record within six months prior to the expiration. Why? You want to continue it on for other five year periods. For release from the collateral described – so, it's releasing the collateral.

The next one is assignment. A secured party certifies that the secured party has assigned to the assignee all the secured party's rights under the financing statements. So, you're assigning it to somebody else.

The next one is a termination. A secured party certifies that the security party no longer claims a security interest. Great. The last one is an amendment. The financing statement is amended as set forth. You're going to make a change in it. So, it's used for all these things.

The thing that is quite often forgotten is the fact that when the thing is paid off, a lot of people forget to have this thing removed, and what happens is you come up to buy the business and you find there's still a lien on the business. What I want to warn you also in this area – if there's a lien on the business, and even though the seller is telling you it's been removed, we find quite often that what we should do whether we're listing it or buying it is back-off, let the seller have it removed, and then tell them to call us as soon as it's removed. Why? Because quite often that little $50,000 lien on there is clouding a five million lawsuit that's about to be filed. So, let's clean the thing up as much as possible. Do not take a "Subject To" – we just back off – no "Subject to" and we also don't say the sellers going to indemnify it guaranteed there's no problem because although they may be very wealthy and be worth hundreds of thousands, the lawsuit behind it may be for millions. So, let's take it safe. Take your time.

The next thing is a UCC-3, and that's the information copy and you're going to find it's mailed to the Secretary of State with X number of dollars depending on what state you're in, and you'll send back the financial information on that state. The only bad news is sometimes depending on how busy they are, it takes a week, week and a half, or two weeks to get it back. If you'll check with your local escrow company or your local title company or attorney that works on business opportunity escrows or closings, you're going to find by going to them, they will tell you the different companies in your city that actually provide service, and will give you this information on liens within a couple of hours.

By calling these people on the phone, they will get information on your company, and they will then call their service that's in your state capitol. They'll walk across the street. They'll research it and call you back in two, three or four hours. You then have a verbal response.

If you then in writing in a couple of days, you'll get the written copy of it in the mail. It's not very expensive, and for those of you in a hurry, go that way. Incidentally, I don't care how clean you think a company is, always do this. I don't care if you're the broker, the seller or the buyer, just run one of these prior to the time you're about to sell it or mention it to somebody so you can find out ahead of time if you're about to have any problems because a lot of times you may have a lien on it that you forgot about it or it just may be something that's come up that's a mistake. So, let's get it taken care of.

The one thing I want to tell you also about the three different UCC copies is you go to different states, and all the states I've been in they do have three different copies, but what they've done to be a little creative, what we call here the UCC-1, they may call it two. They may call it three. They may call it one. So, you're going to find a variation in that area.

But, as you go out to look at the basic form, the basic form is the same. A few lines may be different, but the concept is the same and the information required or the things that the forms do provide is the same in every category. But, again, I'm sure it would be nice to have standard statements, but we don't have that.

As you turn the page, we're going to start talking about a thing called inventory because as you start to think about the closing period, when you think about the other, you're probably going to say, "Why don't you provide a complete checklist in this area you can use?" Well, we've looked at that over the years, and we certainly would like to provide a checklist, but the problem is we can not provide a checklist other than what we're about to go through that would apply in enough areas because in most categories you're going to find that as you go to the escrow company, the title company that you're working with, or if you're going to the attorney or whoever's handling the escrow – it could be a CPA – you're going to find that they already have checklists. They will give you a checklist, and the good thing about the checklist they're going to give you, it will apply in the area that you're buying this business in or you're selling the business. I'd rather have you do that then us give you something that's going to mislead you. So, what we'd like to do is just take you through the areas that are general and the other areas you're going to have to get the specific information from your professionals.

Inventory – taken by independent appraisers. We talked about this before, but the thing you have to realize is we're talking about taking the inventory and usually you can have the buyer and seller take the inventory a day or so or a couple of hours before the thing closes and the buyer takes over. But, the thing you have to realize is buyers and sellers normally fight when they get down to the inventory point, and there's a good chance of blowing the transaction. Also, if you happen to be a broker, it's not too good to have them take the inventory because everytime there's a discussion between buyer and seller, and they can't reach a decision, they will usually call you the broker agent over and have you subtract it from your fee, which is a nice way for them to settle an argument. Most of the time, the broker will go along with this which is not fair to the broker.

What we say is the independent appraisers – they're listed in the yellow pages of the phone book – and again, these people come in for a very small fee based on how many hours it's going to take. They'll take the inventory. You'll also find in most cases they are bonded which means if there's a mistake made, you'll find that they're insured for the mistake and they'll make it good. And, you're also going to find one other thing you're going to find is they specialize in certain areas. Again, they will have specialists within the specialty areas which means they know more about the inventory than usually the seller does. In most cases, the buyer of a business is not as knowledgeable as the seller. It's a good protection for the buyer to use an outside company. We recommend it highly, but again it's up to you.

We start to get involved with sales tax. We have two different sales taxes. Number one sales tax you're going to run into is a sales tax that is collected from customers or clients of the business. This is collected by the seller normally, and the seller has collected this over the past month, the past two months whatever the collection period is, and this money is owed to the state in the transaction.

Now if you happen to be in a state where you collect sales tax, you're going to have to realize that the state sales tax organization has to be notified. If you do not notify the state sales tax organization that the business is selling and they are entitled to a sales tax, you're going to find that we have a thing called "Successor's Liability". The law of Successor's Liability basically states that in this case if the seller has collected the sales tax and either the buyer or the seller or somebody has not notified the state sales tax organization of the sale, then what happens is the state has recourse against not only the seller who's collected sales tax, but if you happen to be the buyer, you also are going to become responsible for the sales tax that was collected by the seller before you even bought the business. So, you better make sure that the state is notified. They don't like to be ripped-off.

Why do we have these laws? Because in the past, they've been ripped-off a number of times.

The next thing has to do with sales tax that you collect on the sale of equipment, and again, we talk about California. There's a couple of other states in the United States that collect sales tax on equipment, and when you have a collection on sales tax on equipment in a transaction, the state has to be notified. Now, normally the buyer is responsible for paying the sales tax on equipment either during a transaction or after the transaction, and the buyer's responsible for the sales tax. Now, because the state has a hard time collecting the sales tax from time to time, we again have the law of Successor's Liability which states that number one the buyer is liable for paying the sales tax, but if the buyer does not notify the state organization, the seller also becomes responsible.

Where we have this most often is after you take over the business and you decide you have some excess equipment, the buyer's going to say to you, "Gosh why do we have to contact the state? I'll just pay you the $10,000 for the equipment, and we'll save whatever the percentage is." What happens when the state catches you, you're going to find they have a hard time finding the buyer of the equipment, but they always have access to you the owner. So, what I'd suggest you do is play it by the book. Do notify the state. It's only there to protect you.

Utilities – please remember to transfer the utilities to the new owner before the closing or you may become a new account with a large deposit, and you have to realize many times we're going to be doing a thing called dissolving a corporation. If you're dissolving a corporation during the transaction and you're changing the names, you may have to go back to the utilities and change. In fact, in most cases you do. If you're going in as a sole proprietorship, and again, you're taking over on a Monday, the normal owner of that business is going to go in on Friday. The owner of that business is going to change and take the utilities out of his or her name. The problem is if you don't get in there also before the weekend, the utilities will consider you a cancelled account and on Monday about six a.m. they'll cut off all the utilities. When you then take over the business in the morning, you're going to find all your employees outside because there's nothing working. As you then go down to the utilities to have it turned back on, they're going to consider you a new account and they're going to want beaucoup dollars for deposits. So, I suggest you do it a head of time. This is one of the goofs that a lot of people get themselves involved in.

Special permits and licenses, next page – a license or a permit may be required for new application. Again, a lot of you think about liquor licenses or beer and wine licenses in different states, but the other thing you better keep in mind how about having to take over the franchise agreement. I mean, you're going to have to have approval on that. Suppose you want to take over a Ford or a Chevy agency. Either Ford or General Motors is going to have to approve you or you can't go ahead, and for those of you that don't want to get approval, and want to take over the business subject to, I can tell you a number of horror stories on this from people that took over auto agencies and couldn't get approval. When they don't approve you, guess what you can't get. They won't sell you any of their cars. It might be motorcycles. It might be a Kawasaki dealership. It might be a tractor dealership. On these, you're going to need approval on a distributorship or the franchise. So, you better make sure you get this. In fact, when you write the offer, the offer should be subject to you getting approval on you taking over as a buyer.

Franchise status – we mentioned this many times. If you happen to be a state that does have franchises or does have a franchise law, I suggest you check with the corporation commissioner right at the end of your attorney check to make sure there's no cease and desist order that's been issued.

Now, keep in mind, that we've talked to a number of people from the Department of Corporations from different states, and they tell us that they do not give out information on their investigation until after they've finalized because of problems with lawsuits.

Department of Employment – you need a Certificate of Release from the State Department of Employment or the buyer may be liable for unpaid unemployment taxes and employee benefits such as unemployment and disability insurance. So, please contact them.

Local taxes – local tax releases should be obtained. Again, I'd love to give you a list on this, but this keeps going on and on, and as the tax burden keeps shifting and the government wants to collect more taxes at different levels, it's impossible for us to keep up or even put it on a checklist. So, what you're going to have to do is check as you get involved and then be prepared for more of them on a year to year basis.

We'd like to remind you to assume the phone number. Take it over. Please assume the post office box, and the last thing, please remember to refile the fictitious business name if you're in a state that requires it. In some states, it's not required anymore. What you're doing here is if your name is Art Hamel, and you're operating as Johnny Jones, they want you to publish that in the newspaper so the creditors will be aware of the fact that you're working under a name, or operating under a name other than your own. So, it's operating under another name other than yourself.

One last thing I want to mention, and it's a thing we have a hard time figuring out where to put it. It probably should be in the section by bulk sale, but a short while ago in this tape, we covered a thing called bulk sale and in covering bulk sale there's a little warning that we have to give you now, and the warning has to do with the fact of what happens if you are going through and buying a corporation.

Now, if you buy the assets and liabilities of a corporation, there's not much of a problem, but suppose in buying a corporation you decide to buy the stock. Now, if you buy the stock, one of the things that we have recommended over the year not because I'm smart but because the attorneys I work with all over the United States have recommended it – not recommended it – forced me to do it. We usually do not keep the corporation that we take over, and what we normally do, and I don't know the steps – you're going to have to check with your attorney on this, your tax attorney – you're going to find out what happens during the escrow or closing period. We will take the corporation that we have purchased, and the attorneys then will form a new corporation for us. The purpose of the new corporation is at that exact moment that the thing closes – the escrow or the closing – and the lightning strikes and all the money shifts from person to person, and the buyer ends up taking over the business, you're going to find that basically what we have here is a situation where we have a problem, and when you take over a corporation, you buy the stock, you're going to find that you take over all the assets known and unknown, all the liabilities known and unknown.

Now, you can't get protection under the bulk sale because the bulk sale basically puts a notice in the newspaper and allows you as an individual to come in and pick-up the known assets and liabilities which is fine with a sole proprietorship if you buy assets and liabilities of a corporation. But, if you're buying a stock whether you run bulk sale or not, it doesn't make any difference, as soon as you take over that stock, you take over the lawsuits that haven't been filed yet. And, even though there are no lawsuits on the books, you're going to find about an hour after you takeover 15 people are going to sue you for 40 million dollars. Why? Because the old owner was a flake, and you now are the new person which is very honorable, reputable and probably has a lot of money. So, they're going to go after you.

You're going to find also, how about the unpaid payroll taxes? How about the unpaid matching payroll? How about the fraud the former owner committed? You then become the new stockholder, and also known as what? I think it's called stuckee. No, that has nothing to do with the stock. It's another term. We'll cover it in the next section of our tapes.

What I'm trying to tell you, what you should do is sit down with your attorney and decide whether you want to keep that corporation. What we do in most cases is we will have our attorneys again dissolve a corporation and will then have our corporation move in at that last moment when the lightning strikes and take over the known assets and liabilities. The ones that we don't know about then remain with the former owners of the corporation, and they get stuck with the problems they caused for themselves.

There's one other way you can consider going and you can have them do a thing called indemnify. In other words, have the former owners guarantee that there are no other problems or no other debts, but the problem is even though the owners are going out of this business and may be very wealthy, do they have enough money to really protect you against what you could get hit with? Again, I'm suggesting that you talk to your attorney and decide which way to go. Again, in most cases we find we go with a dissolution of the corporation because it keeps us out of trouble. Not go out and buy a business. You can do it!

Special Report Michael Senoff Interviews Art Hamel on June 8th 2004

Art Hamel, business buying expert reveals how to get investor financing for your own million dollar dream business using little or none of your own money without the hassles of snobby bank lenders and invasive background credit checks

Learn ...

- How to value a business
- The truth about government funding.
- How to buy a business with no money of your own?
- How to value a business using a third grade math formula.
- How to determine if there are unpaid bills before you buy.
- How to measure and value the "public good will worth" of a business before you buy.
- How do you keep employees from jumping ship after the sale.
- Why everything you have ever been told about business is a big lie.
- Learn Art's best technique for finding profitable but under valued businesses.
- Why never to trust a business brokers in the Midwest, specifically Indiana?
- How to get the banks to work with you as a last resort
- How to get 100% financing for existing businesses?

- The truth about business plans.
- How to find good managers/directors to run the business for you?
- How much involvement you should have in your new businesses
- How to protect himself from overpaying for a business.
- Why a business investment outperforms real-estate 2 to 1
- Why creative financing will get you nowhere when buying a business.
- How to make your business irresistible to sellers when it′s time to sell.
- How much should you pay for a business?
- How long should the seller teach you the business before he splits?
- How important is it for you to enjoy the type of business vs. the money
- Three warning signs to look for that tell you if the business is sick?
- Top three options for financing a business-what's best for you?
- What kind of businesses NOT to get involved in and why
- What type of businesses is best to look for
- How to buy and control a business away from your home.
- What research to do on the competition before you buy
- Can you buy a business even with past credit problems
- Learn why Art’s business buying methodologies work from Singapore to Scranton Ohio
- Should you buy a business outside your sphere of knowledge?
- Where is the best place to find businesses for sale
- How do you know if you're getting a good price
- Why a bargain is not a bargain when it comes to buying business
- AND MORE

ART: In my experience with the companies I've owned, we had a hundred and some thousand people that went to our seminars in a fifteen-year period, plus all the tens of thousands of peoples I've worked with outside of those areas. So, this is not based on some fantasy I have or something I read in a book. This is based on actual experience.

What you're going to find is the easiest thing to do is use investors. In the first 25 years I was in business, I got owner financing. I got bank financing. I had vendor financing. I did all sorts of things. But, what happened was, I didn't realize there was investor financing. The only reason I got into investor financing and got investors to invest in our companies, about 25 years ago, we decided to go to Mexico. Nobody was going to finance anything in Mexico. Even today, they won't. So, I had to go back to investors that we had and talk to them. I didn't even realize that they would do something like this. So, I just sort of lucked into this. The last 25 years, we have never gone to the bank other for a line of credit. We don't ask for owner finance. We pay 100 percent cash on the deal which means that the seller gives us a better price than a small cash price. We don't have to qualify. We don't have to give our financial statements. We don't have to do anything. In fact, the average seller will tell you one thing, if you give me all cash, I don't care who you are or what you are – in fact, if you have a pet rock that you want to put into manage it, that's fine with me as long as you give me all cash.

So, what happens is if you bring an investor in as opposed to all the other types of financing, it's a lot easier way to go. The other thing is with an investor most of them will ride with you for four or five years. In other words, if you show them what their share of the profits going to be for four or five years, many of these investors do not ask you to pay a return every month or every quarter which means you have all the cash available in the business for a four or five year period to expand it. It's really a fantastic way to go, but I want to tell you for the first 25 years, it never dawned on me because I didn't know how to find investors.

MICHAEL: Here's a question, Art, from Al Stauffer of West Des Moines, Iowa. "Given the value of business includes the existing customer base, what advice would you give on working collaboratively with the existing owner to affectively transition those business relationships to the new owner? And, there's quite a bit of information or propaganda on obtaining business fund from government sources. Are the government programs truly viable sources for start-up and expansion capital or is it just a bunch of hype?"

ART: First of all, when you're talking about working with customer lists or customers with the seller, we usually start working with the seller naturally before the close. The seller's normally also going to stay around for a month, two months, three months afterwards to help you with the transition, but again, we don't wait until the day we close. We start doing it ahead of time.

Now, the seller's not going to allow you to do that too many days ahead of time because they don't want the word out too much before the close. The key thing is I, in all the years of doing this, I've never had any trouble with a seller transferring this over.

Now, the other thing that happens is a lot of times when we're buying a company, the seller is either staying to manage it or staying to run it, and the people in the area really do not know that there's been a change in ownership. Now, sometimes the people that are supplying, but a lot of times we're talking about a corporation and the corporation name is "ABC Corporation". The new corporation is still going to be "ABC Corporation" so, it's not something that in the 50 years I've been in business that we've really had trouble with, but it's something to consider.

MICHAEL: Do you work across into the contract to anything that keeps this smooth transition?

ART: Well, it's such a smooth transition if there's something that the seller does not bring up that causes you to lose that customer or the customer is endanger of leaving, and find out after you take over, there's always a paragraph in there that covers that, and the seller also realizes that they're going to have to give part of the money back if that is the case.

See, the thing we have to keep in mind, and I found this in the early years of teaching and of being in business, most people have a lot of thoughts about the negative things in business. They have a – I used to ask people, "Make a list of 50 different things that are going to keep you from succeeding in business", and what happens is people write down all the things they've heard from their mother, their father, all the scary stories out there, and I tell them to take the list of 50, put them in a drawer or safe deposit box, and then after you buy the business, take the list out. In all the years I was teaching which 100 and some thousand people, I told every one of them, "If any one of you run into one of these things that come up that you wrote on that list, come back to me because none of them exist. You've all held back and you have not succeeded in business because of things that aren't true", and incidentally the things that aren't true really relate to people that have trouble in business. The people that are successful in business, don't go out and complain. So, all you hear about is the feedback from the different people that have screwed up some.

The other thing you had asked me about, you asked government financing. Well, you have SBA loans – Small Business Administration loans which are guaranteed which come and go. Those are usually up to a million dollars. We don't work on businesses that small, but I have assisted people over the years with this, and if you go that way, you're going to find that it's actually easier to go to a bank and get the bank to give you a loan. You go to the bank to try to get an SBA guaranteed loan. In other words, if the business thing you're doing makes sense, the bank will actually lend you the money on the same terms as you could get with government financing, but there's a lot of people out there that sell a lot of seminars based on showing you all these great techniques that you have for getting government financing. You ought to just forget about it because it's just a waste of time.

MICHAEL: You're saying business under a million, it is possible to get government financing, but there's so much red tape, it's easier to do it through a bank?

ART: Yeah, because what's going to happen is let's say you get a million dollars, the business itself should be enough security on that, but what happens is they're going to ask you to put your house up, your car, your kids, and everything else. It's a very tough way to go. If you want to check, just go to the government and ask them for their sheets that you have to fill out, what you have to perform to get that loan.

Again, unless you're buying a large donut shop, it's not worth going after. Those are not big businesses because the problem is they put you in a category of business. They're going to drive you nuts and turn your hair grey, because as I have always found, if you go after a business that nets over $250,000 a year, and they're easier to finance then the smaller ones, you're going to find that the manager of your company is going to call you and bug you all the time because he's going to be making enough money, but he just considers you a hindrance.

MICHAEL: Here's a question from Alan Watson – "How do you find out that the person selling the business does not have a similar business in a different location which allows him to doctor the books and stocks, et cetera to make the business they are selling look better?"

ART: I have run into that a couple of times, and I was thinking of one here in San Jose, California. There was a taxi company. The guy owned two taxi business, and I was only aware of one of them. First one in, there was one taxi company, and I noticed on one of them there was no labor. What he was doing was he was pumping all the labor costs into the other business which was showing a loss, and that business that was showing a profit which he was trying to sell there was no labor costs.

So, what you have to do is you have to be very careful. Now, the thing is when you go in and check books and go through all the due diligence that you normally go through with a good CPA or somebody else that's assisting you, you're going to find that during that 30 day period which is the normal due diligence period, all this stuff normally comes up.

Also, you're going to find as you ask the seller a lot of questions, the seller has a tendency after a while to start confessing. If you don't ask anything, you won't get any extra information, but if you continue to check and do your due diligence, almost all this stuff comes up.

MICHAEL: Okay, so in the research stage, if you're doing your job, you should be able to determine these kinds of things.

ART: Yeah, all the ones that I've run into have come up in the first couple of days. In other words, but unless you're very naïve, they're going to be very apparent to you when you start checking or talking, even when you start talking to the owner.

MICHAEL: Here's a question from Albert Franklin in Modesto, "Are there businesses that can be had for no money down?"

ART: Okay, first of all, when I was teaching classes, everybody accused me of teaching how to buy business with nothing down, there's no such thing. Now, can you finance a business 100 percent? Yes. Can you get a business with nothing down? No, because in all the years I've been doing this, I've never run into a seller that will let you in – I'm talking about not a dog, not a turnaround business, but a normal, good business. I haven't found any that will let you in with nothing down. It just doesn't exist, but if you find one that makes sense and it's large enough, you can finance it 100 percent or close to it, which is basically the same thing.

MICHAEL: Here's a question from Mike, "I have looked at buying a business many times. Many are selling a job not a business, requiring financing that I currently do have."

ART: What you have to realize when you're working with investors say as an example, the whole life changes because when you go in and you try to get owner financing say as an example, the owner's going to qualify you, the owner's going to ask for extra collateral on these things, all sorts of things. They're also going to look at you a lot differently.

Now, when you come in to buy a business, you have an investor or investors, you're basically not asking for financing. You're paying all cash. So, you don't have to go a bank. You don't have to through the seller. What you do is you have to talk to the investor, and all the investors – not all of them, but say 99 percent of the investors that I work with – are business owners. So, they're not using ratios. They're not banker mentalities. It boils down to one thing. If they thing that you're doing makes sense, and if you and the investor get along, you like each other, you're going to find you get the money.

The most difficult thing is getting off your duff to go out and find a business, a good one that makes sense. That's the most time consuming and the most difficult thing.

MICHAEL: Here's another question – there's a lot of talk out there that there's an average value of a business. Is it 2.3 times the net revenue for some or others? Or is it just one year's annual revenue net? What is the formula or is there one?

ART: Okay, the one thing you have to worry about is when you get involved with people that want to use annual figures because all the times they're trying to use annual sales not nets, and don't ever get trapped into buying a business based on the amount of sales they have because it could be doing a couple million dollars a year and not make any money. Why would you want to buy something like that?

What you have to do is you have to get it back to net profit or EBITDA or whatever you want to call it. I don't want to get involved in what that means, but what is the cash flow of the business? And, what you're going to find is the multiples, the magic multiples that you have against net profit change. In other words, you'll find a business that's selling for say 300,000, a smaller one, and that one may be one or two times net. You get up over a million; you may find the same manufacturing business will go for four to five times net. So, what you have to do is you have to get out there to get the category you're going to go after, and then start doing your homework to find out what the market values are within that range because it varies by size. It varies by type – it could be manufacturing, distributorship, or a retail business. So, there's all different multiples, and what you have to do is find out what the average category, but once you get out there and start looking at a few of them, it's going to become apparent to you what the going rate is for that business.

MICHAEL: Where can you find those values?

ART: There are books that are put out by business broker associations. So, if you know a business broker, you can ask them to look at their catalogue, but those are mostly gross multipliers are opposed to net.

What you do is you go out and find businesses that are for sale, and basically you use that as a guide. In other words, we just looked at ten businesses for sale. We just experienced five businesses that have sold. We now are going to have a range of what they sell for, and you're going to find they're pretty much in the same category.

Now, if you find other ones that are trying to sell for larger multiples, I think you'll notice that they don't sell, and then eventually the seller will get to the point where he adjusts the price down to what the market is.

All the information is out there. It's not difficult to get. It's mainly going out and looking at categories because a multiple in California for a certain type of business might be different than it is in Akron, Ohio. So, find what it is for the area you're going into.

MICHAEL: "Dear Michael, hello again from Seoul, Korea. Here are my questions for Art." Here's three questions. Let's just take them one at a time. This is from Charles Jenkins. Number one – how do you determine if there are unpaid bills and/or not so goodwill in determining the fair purchase value of a business before making an offer.

ART: When we offer to buy business, there's two things you're going to find. Number one – the seller is not going to divulge and let you go involved in a lot of the information he has before you make an offer. So, what we're normally doing, 99.9 percent of the time, we go in and offer a letter of intent. In other words, I the buyer offer to buy your business for $500,000 with the following terms and conditions. It's a non-binding contract. I'm asking you to let me have 30 days to go through a due diligence period. At the end of that time, we'll sign a contract.

MICHAEL: Do you get any money down at all?

ART: Okay, on the due diligence, the broker of the seller would love to get down payment money on a due diligence contract, but it's not done.

MICHAEL: Is that what this? A due diligence and a letter of intent is the same thing?

ART: No, the letter of intent covers the due diligence period. So, what happens is we will put up a down payment when we get to the contract period which is what we're doing in that area.

MICHAEL: You have 30 days to explore.

ART: On the average of 30 – we have some that say, the owner or the broker doesn't provide us with very much information. We get two sheets of paper on a large business. We might have to ask for 60 because we're going to have to put together information that should have been provided for us by the broker or the seller. So, we're basically putting together a business plan. Hopefully, the broker or the seller will have put that together, but if we have to put it together, it will delay the close, but we usually are able to explain to the seller and or broker the reason for it.

MICHAEL: Do you find the business seller usually wants to hold back that stuff and you're usually required to push them for more information in that research phase?

ART: You know the simple thing, if you stay away from turnaround dogs and sleazy sellers, and your gut level will tell you that, if you buy a good business making a good profit, the seller is very glad to tell you exactly what he's doing. He's going to be bragging about it.

The only ones that hide it are the ones that they own a restaurant, and is going to tell you about the skim they have. These never exist, and other type things. But as soon as you run into somebody like that, what you should do is walk away. The average person is going to give you all the information. Not getting the information is the exception.

For those of you who worry about that, get away from the worry. Go out and look at a couple of businesses as if you're going to buy them and see what happens. What you're going to find is the average seller is a nice person to work with and is going to treat you very well because he or she who has the cash does the talking so, you're going to find them very willing to do that and very willing to give you all the information. Again, it's the exception that we're talking about right now. I don't run into it very often.

MICHAEL: Okay, here's another question from Charles Jenkins. "How do you keep any valuable employees in the company you buy from leaving to join a competitor when they learn the business is being sold to someone they might not know?"

ART: Okay, what happens is when you worry about employees leaving, we just management contracts, and your attorney can help you draw the thing up. Now, keep in mind, when you're doing this, be fair because what you're trying to do is keep the employee, and you're also trying to keep from getting hurt because what's going to happen is if you have an agreement with your employee and your employee decides to leave or do something wrong, you're going to find the contract you have with them when you go to court is going to be looked upon by the court as protecting the employee, not you. So, the employment contract or management contract whatever you want to call it, is basically in favor of the employee, but it makes them feel good. But, if you're going in, you may say, "I have three or four key employees. I better make sure they stay." Well, I have done that in the past, but I have not done that recently because I've gotten to the point where I realize that if I treat the employees well, they don't leave. I can't remember the last employee we had leave I mean anyone. We treat our people well. We give them above average wages. They get above average pay. We treat them very well, but again it's one of those things that you read about and people worry about that doesn't happen.

MICHAEL: So, let me ask you, I'm just confused. This management contract – are you suggesting is, I'm looking at buying your business, Art, and you've got key employees. Is this something that I get your employees to sign or you get them to sign? I don't the management-

ART: The buyer negotiates it with the employees of the seller.

MICHAEL: The employees after the business is sold or before.

ART: You're negotiating it before because if something comes up – you can't negotiate it afterwards because you can't tell how it's going to come out.

MICHAEL: I see, so you would ask the owner of the business to talk to the employees about this.

ART: Right, but only key employees and again, the seller always worry about one thing. They worry about the fact that the work's going to get out, the employees are all going to leave, your customers are going to drop you. So, you have to be very careful doing this. So, what you do is you set the thing up to talk to whoever the key employees are, who you think they are, and do it that way.

Now, we've had some cases also where we have signed or put together the management contract after we takeover, but that's dangerous.

MICHAEL: The owner of the business before he sells it would ask those key employees to sign this management contract.

ART: No, what would happen is the owner would set up a meeting between the buyer and the employees, and the buyer and employees would negotiate. It really has nothing to do with the seller.

MICHAEL: Okay, you just have to feel it out.

ART: Yes.

MICHAEL: Okay, here's another question, "Hi Michael, as I'm just putting up a business for sale site, this topic is of extreme interest to me. So, two things – one with all the financial scandals involving corporations and accounting firms, how can a buyer protect themselves and get to the truth when examining perspective businesses?"

ART: There is a standard check that all CPAs go through because what happens is you get in there, say you even make an offer or a letter of intent, you've already usually have three or four years of profit and loss, balance sheets, other information on the company. So, you're doing that type work and then after so many days or so many weeks, you sit down with the seller and you draw up a letter of intent. In other words, it's a skeleton of the price I'm paying, what the terms are, how long the owner will stay, maybe four or five things, and also spelling out the fact that we're going to go through a due diligence period. I'm going to be looking at the business. I'm going to be going through it in detail. I'm going to be around. The seller, "My god, it will scare the employees." "Fine, tell them an insurance investigator or something like that." But, they have all sorts of things that they say, but what you have to do is you just do your homework, but if you don't know what the homework is some time you're going to have to bring in a CPA, an accountant but usually a CPA, and usually you're doing it toward the end of the deal because you don't want to have that cost and have the deal falling apart.

But, once you bring the CPA in, they're going to be able to tell you what you should be looking for and then they're going to tell you what they're looking for when you go through the books.

MICHAEL: That question was from Dawn Broder. Okay, here's another question from Doug Graham, "Hi Michael, I'd like to ask Art what is his best technique for finding profitable but undervalued businesses."

ART: Okay, first of all you have to get this undervalued out of your head because you're going to find the return you get on the money you've invested and time you've invested and the investors invest, is going to be very good without going after underperforming businesses because if you see that, you're looking for dogs, and you're going to find in going after a dog or a turnaround or underperforming, you're going to find that even if you solve that problem and you get your picture in the paper, and the put you in "Inc" magazine, I'll make you a bet on the next three or four that you work on, you go bankrupt and you dump every one of the companies that you have.

It is less expensive and less worrisome and troublesome to go after good business. You don't want those.

MICHAEL: Here's a question from Grant Siegel, "Do you know of any good businesses brokers in the Midwest specifically Indiana?"

ART: He's talking about business brokers. I've been in this business for all these years and I've worked with a lot of business brokers, and the problem is trying to find a good business broker is almost an impossibility. I never in my life, had ever recommended a business broker. The reason for that is there's very few out there that are very good, and I do not want to get in the position of referring somebody and you get screwed on the deal, and then you come back and sue me because I gave it as a reference.

I have met so few out there that I consider legitimate or know what the hell they're doing, that I can't get a recommendation, but what happens is if you go out in the marketplace in Indiana and start to check on businesses that are for sale, you're going to find that most of them are going to be listed, the better ones, by brokers and is you go out and look at a couple of them, it's suddenly going to dawn on you after a couple of weeks who you're getting along with, who's going to give you the most assistance, and who is doing the best job.

One of the problems you have with business brokers, they try to qualify you financially or experience wise, and so what you have to do is you have to get in your head ways to get around that so they don't end up intimidating you.

MICHAEL: Can you give us an example of one or two ways to do that?

ART: Well, you know, I've been thinking about that and it suddenly dawned on me that when I go out to buy a business, there's two things that I have that's beneficial to me. Number one – I've been doing this for 50 years. I've owned many companies. So, when I go out, nobody's going to challenge me or nobody's going to say, "Well, what experience do you have?" They know or I can prove to them that I have experience.

The next thing is the money. I know I have access to the money. I either have the money or I could access it. I'm looking very positive. What you have to do when you go out there if you don't have any experience at all, you better get a couple of people on your team that looked it so that the broker and or seller is going to look favorably upon you.

Now, if you're paying all cash on the deal when you buy it, the seller's not going to look at you at all. Either is the broker. All they're going to do is look at you as a piece of meat. In other words, you're somebody who has X number of dollars to buy this business – all cash – and that's all they care about.

MICHAEL: That makes sense. Here's a question from Glen Gobel, "I need to know how to value a business. I am an osteopath and want to buy other practices. There's not much in the way of fixed assets, so it is goodwill et cetera. I also want to buy these with as little of my own money as possible. How do I get the banks to work with that idea?"

ART: Okay, let me work in reverse. With medical practices, you can get financing through the bank, but also with medical practices, it is easier – probably the easiest type area to get investors in because a lot of the investors are in the business or in the health field, and they're interested in putting more of their money in other practices or other businesses in that area.

When you go out to buy a business, you want to look at it from a returns standpoint. The average business, and I don't mean a little donut shop, but the larger businesses – I don't mean General Motors, I mean the ones sort of in the middle – usually have a return of 25-33 percent return on the money.

Now, what does that mean? That means if you're buying a manufacturing company and the thing is priced at four or five times net, that means you're getting 20-25 percent return. When you get into service businesses, instead of paying four or five, they're usually going for three times net. Now, keep in mind, it depends on the size of the business. So, you're going to find the same manufacturing business or distribution company may sell for one and a half to two to three times what a service business goes for. You're also go find on the low end, even with medical practices, that a lot of times they're being sold for one time the net.

So, what you're going to have to do is check the market in your area for the type business you're looking for, and try not to use averages because you'll end up fooling yourself. Go out and check the market. See what's available, what's selling, what has sold – use that as a guide or you're going to overpay seriously.

MICHAEL: Here's another question for Jason Seprick from Perth, Western Australia. "Hi Michael, I have a couple of questions for Art. Your original interview with him is one of the ones I enjoyed the most on hardtofindseminars.com. Number one – do you believe in buying businesses which fit into a buying cycle of the consumer? For example, a business that fits well with baby boomers right now or a biotech/vitamin business for the aging population?"

ART: Okay, now I have people I work with that go out and go after businesses that way. They go out and take categories that they think are hot today, or let's say I buy a business. The average business I buy nets between a million and two million dollars and have for the last couple of years. When I go out there, I'm looking for manufacturing with a product.

Now, sometimes we're getting into something where the product is hot and ready to go now, and other times it isn't. If you want to go out and target companies that are in those growth areas, that's fine also. It's just that it becomes a little more difficult and you're going to have to widen your scope because you may be in Indiana say, as an example, or Australia, and you may find that the business that fits what you're looking for is a long distance away.

Now, keep in mind, if you go after a large enough company, and let's say it's making 500,000 or a million dollars a year net profit, you're going to find that your management is going to be paid X number of hundreds of thousands, 150,000 dollars a year. That manager's not going to bother you.

So, can you manage it from a distance? Yes, in fact, that's what I had done for the last 25. I have not worked hands-on for any company. If you want to keep from getting grey and old before your time, consider not being a hands-on manager because one of the best things that happens is you don't have people bugging you all the time because you're not hands-on. There's a manager there that takes care of the problems, and the other things is if you decide you want to own more than one business, it's very difficult when you're running one of them yourself.

Once you pull away and don't run those businesses, you're going to find that you own multiple companies. You're going to have less stress than the average guy with the little donut shop. My experience with the companies I run – we have a hundred and some thousand people that went to our seminars in a 15 year period plus all the tens of thousands of people that I have worked with outside of those areas. So, this is not based on some fantasy I have or something that I read in a book. It is based on actual experience.

MICHAEL: Here is another question, "I know you're not really in the seminar business anymore, but can anyone who purchases your course through Michael contact you for advice, clarification, or would you rather the material speak for itself?"

ART: The material is going to have to speak for itself because I don't really want to get involved in that, and just take this other as an example. We have investors available that we can help with which we charge a fee for, but the thing we have to worry about I've talked to Michael about this, we have a lot of people that just want to talk. The problem is although I have the time and I love working with people and I do work with people that just want to talk, there's a lot of people out there that are time-wasters. So, I've talked to Michael about the fact that if somebody wants to come back to me and just rap and talk, they can do it for $150 an hour. If then decide to go ahead a buy a business and I help them with the financing, we'll refund all their money that they paid on the deal, but the key thing is, again, I found this out in the seminar business years ago, there an awful lot of people out there that don't want to do anything but just want to talk about it, and I'm getting too old for that.

MICHAEL: That's fair. Here's another question from Jeremy Wood, Freeport, Michigan, "Hello Michael. I'm excited to hear that you're doing another interview with Art Hamel, and can't wait to hear about. I've bought the course a few months ago, and I really liked it. I'm ready to get rolling again with buying real estate and or a business. Question for Art – what do you do as far as a business plan goes for the business you're buying? Do you take the information on what the company currently is doing and then add what you intend to do? Will lenders or various sources want to know very much about me the person buying the business?"

ART: Okay, the business plan – If you're lucky enough to find a broker or a seller that has put together a business plan which you can use to buy the company or get financing or whatever, you're going to be very lucky because a lot of times today, they only put together two or three sheets of paper, and then if you need financing or you need an investor, you're going to have put together a business plan which is going to take you a couple of a weeks or a few weeks. You either do it yourself or you're going to have to hire somebody for five or ten thousand dollars.

If you want to do it yourself, there's a number of programs at your library, just go in the business section of your library, and there's a number of programs. They'll have CDs. They'll have computer programs – everything that you can use to put together a business plan. But, if you decide to go out and raise money and don't put together a business plan, the chances of you getting the money is zero and none.

MICHAEL: Here's a question from Mac from the United Kingdom. There's actually three questions. We'll knock them off one at a time. "How do you find a good manager or director to run the business for you?"

ART: Okay, first of all, if you're starting a business from scratch, that's a very important thing, but if you buy an existing company that's been around five, ten, 15 years and it's doing very well, most of them are managed. Now, there are some out there where the owner's still running the company. If the owner's still running the company, and he's hands-on in there, what you're going to find is there will be other employees that you can move up. In other words, you can hire from within.

You're also going to find that a majority of the companies are being managed by somebody other than the owner. I mean, if you go after something that's good, what you're looking for is you're looking for an owner that plays golf full-time and never shows up. You don't want to go after a business where the guy's there 80 hours a week. I mean, who wants to own that? And, what will happen is you'll find usually within the company somebody running it or whatever. You'll have the manager you're looking for.

Now, can you go out into the marketplace during your due diligence period before you close escrow? Yes you can. Can you find a manager? Yes. Are they easy to find? Yes. If you go out and buy a good business, and you're willing to pay a good salary or fair salary to somebody, trying to find somebody to run that company is not going to be hard at all, but keep in mind this doesn't happen very often. I can't remember the last time, we had to go out and hire a manager and I'm talking the last 20-25 years.

MICHAEL: Okay, great. Here's a question from Michael Morales. Michael Morales actually remembered you and went through your course in the mid '80s, and he asks, "How should a-" Isn't that wild?

ART: I feel old. I go to national meetings that went through it before that. So, that means – I tell people I'm only 37 they know I'm lying.

MICHAEL: Well, he remembers you and he remembers your course and said it was great, but he's got a question, "How should a buyer protect himself from overpaying for a business? Generally, a buyer will give seller carry-back financing that is tied to the income and the profits that the seller promises. If the business as the seller says it is, then the seller loses out on getting paid all of their money rather than the buyer losing out." Does that make sense?

ART: You have to do your homework. You can put your arm and give the seller a big hug. You can look at the business, but take everything with a grain of salt. What you're going to have to do is check everything out that they give you, verify it. On the numbers, you're going to have to bring a CPA in to check four years whatever it happens to be. What you're doing is you're doing your homework, you're checking it out, take your time. And, what you're going to find is all these things will pop out. And, once you go through your first business even if you don't close on it, you're going to find by the time you get to the second one the next week or the week after, the same things are going to pop up. By the time, you've gone out to look for maybe a month, and you've looked a number of businesses, the same things will keep happening over and over again and you'll find you can believe how smart you get, how fast. But, quit worrying. What you have to do is quit letting all these things bug you and go out and check the market, but most of the things you brought up today, Michael, these things really don't happen, but they're part of the 50 everybody always worries about.

MICHAEL: It's just fear.

ART: I know. I went through this at the beginning, too, but I didn't have anybody to talk to. I overcame the fear by screwing up.

MICHAEL: You mentioned you want to get a CPA to check the numbers out. So, you recommend if I'm analyzing several businesses, I should hire a CPA and say, "Look, I'm interested in buying some businesses", and contract them to review the numbers for me.

ART: Okay, no, you don't really have to do that. Once you start going through this, if you have an IQ over 20, you're going to start to see a partner on the PNLs and balance sheets, profit and loss and balance sheets. Now if you need some help on description, that's okay bringing a person, but what we try to recommend is don't bring the attorney and the CPA in until you've gone far into the due diligence period because you may find that three or four of them fall apart and you end up with a large CPA and attorney bill.

MICHAEL: So, do it yourself?

ART: Well, as much as possible. Keep in mind, what you're trying to do is keep your cost down because what will happen is you'll run up these large bills and you'll find a business that you don't really want, and you say, "God, if I don't close on this, I'm in trouble." So, you end up buying something you didn't want.

Now, if you're buying a good company, the average CPA and attorney will roll along with you. They'll say, "Okay, you're going to go through four or five. I'll bill you on an ongoing basis, and then you can pay me after you get your business." So, you don't have that expense as you go along. But, you also don't want to build up expenses because it might take you a while, and what you have to do is take on as much as possible checking out the business. In other words, learn how to do it. And, again, just by going through three or four, you're going to find you will be amazed how smart you get from business to business.

MICHAEL: So, it's basically you need to do it yourself, and learn how to do it yourself and do it right.

ART: That's right, and when you take over the company, don't you want to know something about profit and loss statements and balance sheets, or you're going to be in big trouble.

MICHAEL: The course that I sell goes over all that specifically on how to do that.

ART: Well, that was the purpose of the course in the beginning. We had a lot of people coming to us because I was just basically a business owner and talking about all these problems, and I said, "We need a program out there which we put in the course." Basically just to blow away all the crap you hear about businesses, and that's what the program has ever done. It blows the crap away, and let's you see what is really there, and then do it on your own. And, again, after working with all the people I've worked with over the last 50 years, it's amazing to me that I haven't met anybody that after a short while doesn't comprehend almost they're looking at when they're looking at a business.

A business is not that complicated, and after looking at a couple of them, it's finally going to dawn on you, "Oh, this is not very tough."

MICHAEL: Well, speaking of the course, Neil Phillips from Cardiff, United Kingdom bought the course and he has a specific question. He talks about when pricing a business in your manual, in section 5.22, you give a weighted value to the business based on net profit value. What figures would you use now taking into consideration inflation? And, he also asks, "Have you ever used these techniques to buy businesses in the UK? If not, do you know of any one based in the UK that someone should look for advice?"

ART: Okay, first of all, that pricing was developed about 25-30 years ago. Well, what we did at the time is to make sure that we did not have to have problems because of inflation, because of tax changes or different situations of different countries. So, that's how the thing was set up. We have not gone back to check it or do anything. I still use it as a guide. Everybody I work with, they'll use it as a guide. Everything that we taught in that course is the same today as it was when we first started many, many years ago.

Now, I've had a lot of people come to our program from the UK. I've had a lot of people come from the Far East. In fact, we've had – towards the end - we'd have large numbers of people from the Far East that didn't even speak English. They were sitting in the front row with their translator, interpreter, and the thing was fascinating because I always wanted to know how well I did. Every one of them went out and did fantastically well. I was figuring, "My god, if you can do it. You really can't even understand the speaker." I mean, there must be something here.

What you have do, quit thinking things are different in other countries. Now, I can't speak for the UK. We have purchased businesses in France. We have purchased businesses in Italy and Germany. And, I hate to say everything's the same, but even if you go to Mars, there's only certain ways that you do profit and loss statements, balance sheets among other things, and the people all of a sudden, I mean, here in the United States we have a cross section of people over the period of five years, ten years or twenty. I have worked with people from every nation on this planet that have been here less than a year, and I think I know England, in fact I was just over there. I just got back from a cruise and spending time in London a week or so ago. But, the key thing is if you get involved in the details of pricing and you want to get it down to the net, what you're going to find is you're never going to do anything. What you have to do is go out and go more broad scope. In other words, in England if we're buying a banking company and the priced that two times book value whatever that happens to be, the net is the value in the area. If you're going through the detail that he's going on this, all you're going to do is waste his time. In other words, this is a great study for an engineer or a mathematician, but that isn't the purpose of the program. The purpose of the program is to go out and buy a business.

MICHAEL: *I hope you're enjoying this interview with Arthur Hamel, please continue to part two.*

ART: I had given up retirement. That was my eighth time. I really have given it up. I'm never going to do it again. I'm in the process of buying a couple of companies. I don't know which one I'm going to buy, but that's what I'm doing.

MICHAEL: We talked about that early. What are you going to do when you retire?

ART: I have tried. The problem is I can't. My whole life has been tied around businesses.

MICHAEL: And you love it.

ART: And, I love it, and I love the people in it, and I don't like the retired people.

MICHAEL: You've got to do what you love. It's not work. It's your passion. So, why wouldn't you keep doing it?

ART: That's right. It is my passion. I didn't think of that. I forgot about passion.

MICHAEL: Here's another question from Neil Phillips in Cardiff, United Kingdom, "Have there been any changes in your thinking that you would now include in the course if you were going to write them for the new millennium?"

ART: The new millennium really has nothing to do with the changes. I mentioned it before, and the two things that have dawned on me now as I look back is the fact that I really didn't tie enough of getting your head straight before you go out to buy a business. In other words, getting your team, so if you don't have business experience that's hanging you up, you're going to telegraph it to the broker, you're going to telegraph it to the seller, and they're going to get nervous especially if they provide financing.

Now, keep in mind, if you're intent is to go out and bring investors in or some other way so that you don't have owner financing, what you're going to find is the broker and or owner are going to back-off. They're not going to really challenge you or question you on that, and they're going to give you a better price.

Again, I have never thought of it in detail – new millennium – because what happens is I just go out and buy companies and I've been doing that for 50 years, and I've been doing it the same way. Have we changed anything? We worry about tax laws and things like that or for working internationally what is happening in other countries. But, the average person buying a business is not buying General Motors so we don't normally get involved in what you'd call the big picture. I always tell people that would come to me and say, "How about the big picture?" Let me tell you something. What you have to do is quit worrying about things like this and go out and buy a business.

MICHAEL: Neal was actually – he said he was having problems and I pushed him. I go, “Neil, give me your problems that you’re having.” And, so he wrote to me this, and see how you’d answer this, he goes, “Okay, the problems I’m having here is that the majority of people sell their businesses through agents, and these agents have a specific criteria of how a business is sold. The idea of being creative with finance is not a concept that most people look at over here.” This is in the UK. “They want the would be purchaser of the business to put up all sorts of personal assets as a guarantee as a way of financing the deal rather than either the guarantee be against the business or the financing carried through the seller. The same is true in trying to create nothing down property deal. This is in real estate. So, the big problem over here is getting the creative financing to work. So that is where the difficulties are. If any suggestions could be made as to how to overcome this, then that would be excellent.”

ART: Okay, I worked in the real estate market also internationally for over 30 years with top creative people in the world, and all I can say is although they are a lot of creative things you can do in real estate, if you want to be successful in business, you have to quit being creative because what happens is the things you’re describing in the country that you’re in is the same as the United States. The brokers, they’re the people handling it for the sellers, all want a lot of guarantees. In fact, every deal I go in on, if the person says, “I might finance.” I’ll say, “Okay, let’s talk about financing.” And, by the time we hit five, ten minutes into our conversation, I say, “Look it is so complicated to try to put this together with owner financing.”

Now, the average business owner especially on the large ones, over a million dollars say in price, I haven’t seen one in 30 years that has provided financing. They just don’t do it.

Now, smaller business will do it because the brokers convince them that’s the only way they’re going to sell. The broker also knows if he handles small business, smaller businesses, that unless he gets owner financing, he doesn’t ever sell anything. He can’t make his commissions. So, this is a thing they’re pushing all over the world. I don’t care where you go in the world, creativity doesn’t really cut it. So, what you should do is figure out other ways of doing it.

Again, I hate to keep pushing investors, but you don’t end up with all the qualifications, you don’t end up with all the harassments you get, and if you walk in and you’re on the left side on the street and your investors are standing on the right side with their strong financial statement – the cash they’re going to put into your deal –

nobody's going to get in your way. What you have to do is quit trying to be creative especially with nothing down, or try to do great things with banks without collateral. They're not going to do any business. They have too much experience.

Now, there's a lot of creativity that's used in real estate. I agree, but a lot of this creativity does not transfer over to business.

MICHAEL: What criteria is an investor going to work with you? What are they going to need from you?

ART: Okay, well the key thing an investor's going to want is information on the company because it goes from you the buyer to the business, and that's what you're trying to do. Say you filed bankruptcy last year. If you go out and try to do something under your name, you're never going to be able to do anything.

Now, what happens is if your bankrupt last week and this week you end up buying a business, what you're going to find is with the investors, you're going to find the average investor is spending 99.9 percent of his time on the business because that is the thing. If you're also buying an existing business, even if you don't have a lot of experience or if you don't have any in business, it depends on how strong the management team is in the company you're buying.

Bear with me, for those of you that worry about not having the management experience or don't have the money, there are easier ways of doing it, and that's all I'm trying to tell you.

Again, if you're going out to banks, again, I haven't gone out to banks in 25 years, but the first 25 years of my existence I went through all the same stuff. It's like, "Here are these questions" it cuts me right down to the middle because it brings back memories of all the stuff I used to have to go through, how I had to qualify, how they wanted my house as collateral. They wanted me to sign personally. Do you realize that when you bring investors in you don't ever have to sign personally? You don't have to put your house up as collateral.

MICHAEL: Here's a question from Norman Halit, "Here's my question. Let's turn it around a little bit. I'm in the early stages of building my business, the third year, and I'm building it with the idea of selling it to someone down the road. What should I be concerned with as I build my business to make it attractive to a buyer down the road?"

ART: The first two things that make it attractive to a buyer is increase in sales and profit every year but very few peaks and valleys. The other thing that is important that makes it very attractive to a buyer is strong management. In other words, you've brought people in maybe even beginner people, you've trained them, they've come along, and you have a very good management team in there because that's the thing that carries the business forward.

What you're trying to do is attract them. They're not going to look at the inner workings of your company. The other thing I want you to keep in mind, and although I'm always talking about working with buyers, the one thing I usually don't talk about is the fact that probably 10 percent of our business over the years has been with sellers, where the seller comes to us and says, "I have these great buyers but none of them have any money. Do you have anybody that will joint venture with them or be a partner?" An investor covers a lot of different things because what you're doing is you're trading them their money for part ownership in your company. Believe me, it's the easy way to go, and most of you who are listening to this, if you think about it, you probably would have gone to investors years ago if you knew how to do it.

Again, for 25 years, I didn't know how to do it, and the only reason I'm in that business and have those available is the fact that I stumbled on it. I needed it for Mexico or not to Mexico.

MICHAEL: Here's another question. "My question for Art is a simple one. I have an electronic component distribution business in Sarasota. We are growing real fast and can't get money from our bank because they said our balance is too low. We are spending all our available cash on product purchase. We are turning the money over in 48 hours on our sales by using a factoring company, but would like to finance the sale internally. But, that only leads to more and bigger sales. We have a classic problem of too much success and no funding. We could lose some big sales for lack of capital. All our customers are large corporation like Proctor & Gamble, Hilton, Hewlitt Packard, et cetera. What can we do?

ART: I hate to come back with the same thing all the time. The easiest thing to do on a deal like that is bring an investor in because whether it's a million, two million, five million, whatever the amount is, there's either one person or three or four persons that will come in. Again, this is not going to be a loan, it's going to be equity financing. In other words, you're going to give them part of your company, and although a lot of you worry about giving part of your company, most of the people that I work with, don't want to own common stock or stock in your company, they want to be in a preferred position. They feel comfortable with preferred. If you own the type of corporation that allows preferred stock, you're going to find they're not in a voting position. So, even though you bring investors in you still own 100 percent of the company. You don't own 100 percent of the cash flow.

One last thing I just want to mention, and I want to mention this because there's two different types of investors that we work with. If we have a fast growing company, the last thing we want is an investor, mom and pop, that need the income every month or every quarter because then you might as well have financing. So, what we're looking for especially in rapid growth company like you're talking about in Florida, what we're looking for is somebody that is going to let it ride for four or five years. Then you have all your cash available to do whatever you want.

Also, if you have debt on the company right now, I would suggest that if you bring an investor in that you wipe out all the debt. In other words, bring in somebody to expand it, and then bring in someone to pay off the existing debt. Why sweat it?

And, also the people I work with, I have a very simple thing. I meet with a lot of people that want to invest, and if I don't like them, we don't work with them. So, if you end up meeting me, and you like me, you'll like the investors. And, we also don't take on nit-pickers. So, if somebody comes to us with X number of dollars and they're nit picking all over the place, we won't work with them.

MICHAEL: Here's a question from Kiaro in Melbourne, Australia. "Are there any industries or businesses that you would not get involved in? If so, which ones and why?"

ART: The thing I like more than anything else is manufacturing because there's actually less risk, less failure because what happens is you have more money invested. In other words, in order to get in a manufacturing business, you have money in equipment, you have money in accounts receivable, you have money in inventory. So, it costs more to buy one of those, but the risk factor is lower and the chance for failure is lower.

The next category down would be distributorships. They are not as good as manufacturing, but they're better than the others.

The next one down in risk factor is generally retail, and the toughest one is the service business. The service business gets the lowest price, the lowest value. You can get in for the least amount of business, but you're also going to have a higher failure rate – a very high failure rate.

MICHAEL: Why is that manufacturing is safer than a service business? What are you basing that on?

ART: Let me put it this way. In manufacturing, the success of your company depends on the reliability of your product. The service business, it depends on the reliability of your employees, and products are more reliable that people.

MICHAEL: That's a good point. Okay, here's a question from Rhonda Holland, "Michael, I'm most interested in how Mr. Hamel arranges financing for his business purchases. Does he use private investors or does he work some sort of owner financing in conjunction with something like a sale lease back of the equipment to give the seller some ready cash? I'm also interested in how active he is in the day to day operations of the companies he buys, and also what steps he uses to protect himself from law suits."

ART: When you're talking about sale lease back, or if you're doing anything with equipment or hawking your inventory or hawking any of that, this is things we did continually up until about 25 years ago, and which means we had large debt on the company when we were going in.

Since then, since we found investors were available, we don't' have large debt. We don't have any debt on our companies, and it makes it easier to expand the operations of these companies.

I have not been involved in the day to day part of the companies probably for 25 years. I didn't even realize it until somebody asked me a couple of years ago if I was a hands on owner, and I said, "Yes", I guess I have never wondered. I always use it. I oversaw the management and that. So, I was hands on. I never understood what the term meant.

In Mexico, we had more than one company. We had 17 down there. Another business said, "Well, how could you be hands on? How often do you go there?" I said, "Every six weeks." And, what happens is the companies I buy I have managers, the people running them they get paid a lot of money. The companies we buy, we usually pay them $150,000 a year or more plus benefits, plus part of the company. I never get phone calls. In fact, I go to these national marketing meetings in real estate. We also bring people from these real estate meetings to invest in businesses as investors. In fact, if you go to any national or international marketing meeting, you can mention my name. They'll say that I've been going there for 30 years, and either using real estate or investors from real estate in our business deals.

Now, the next part on protecting myself – first of all, everything I do, every business is in a corporation, every corporation is separate. In other words, I don't have any two businesses in one corporation. I never have in the 50 years that I've been in business. I don't cross collateralize. That means take one asset to finance another one. I also don't cosign.

Now, all the different things that get you in trouble are things that you're going to get involved with if you have owner financing, if you have bank financing, if you do sales and lease backs. So, what I'm saying to you is I hate to tell you that the investor is the only way to go that really makes sense. It's just that it has not been accepted because people don't know how to get an investor, and that's why it hasn't been done, but I can make a list of many, many things, and the key thing is that's the easy, nice way to go except as I told you for 25 years, I didn't realize it was available for me even though I owned a lot of companies.

MICHAEL: All right, here's a question from Tom Dershel and it's kind of related to distance. He says, "Does distance play a factor and would you recommend picking a business closer to home?"

ART: I would recommend one closer to home but not too close. You don't want to live over the store. You haven't lived until you've been close to a business even if you're not managing hands on because there's a tendency to drop by and get involved in the whole thing.

The thing you have to realize is if you're going to have one further away, the minimum net , again it's based on all the years they've been in business, is about 250,000 net. That's after you pay a manager, that's bottom line 250,000. At about that level, the manager really starts to take over and you don't really have an active participation in the company. This doesn't mean you don't oversee it. It doesn't mean you're not involved in it. It means you're not there every hour. When the secretary doesn't come in Monday, you don't really care. You don't even know about it.

MICHAEL: How often are you talking to the manager at least over the phone?

ART: First two months – I'm talking to the manager hourly where I get involved in the first two months. I come in as in-charge man, whatever it is, and what I'm doing is I'm seeing what controls we have, to set-up controls if we need controls, and to become familiar with it. After that, I don't get there very often.

We had one in Florida. Somebody was talking about Sarasota. We had one in that area for 25 years, and always visited it once a year. If that person listens to this, every year when we'd have this, they would have a big reader board on the hotel in Sarasota even though it wasn't even in Sarasota. It said, "Welcome Horrible Hamel the Happy Huckster", and my only point was I wasn't getting any respect. Here was a company that never bothered me. I got to visit them once a year, and all you got was money from the thing over a 25 year period.

There's nothing wrong with being hands on, but all I'm saying is I don't care what age you are, if you'd like to have a healthier life, and maybe own more businesses, what you should consider doing is nothing hands-on. Let somebody else do it.

MICHAEL: Once you do a purchase, you're going to be hands on at least for the first couple months, at least communication and getting everything set up.

ART: Well, let me tell you what the rule is. I tell all my mangers right in the beginning. I say, "Look, I'm a blue collar type guy. As a blue collar type guy, I don't like to work after five o'clock and I don't like to work on weekends. If you ever call me at home after five o'clock with a problem you could have solved, I will fire you at nine o'clock tomorrow morning." True story, I have never gotten a phone call.

MICHAEL: You make it a point to tell them exactly that.

ART: I know, but they love it. They love it because they're getting the run of the company. "We don't have some pain in the butt owner driving us nuts" because this person's probably run the company for five or ten years successfully, right? What am I going to do? If I don't show up, they're going to be much happier and the business is going to do a lot better. I don't contribute anything.

MICHAEL: That's true. What else do you tell them?

ART: I tell them to make the decisions on their own. Let me give you an example I use. We used to work on deferred giving with Stanford University so, Stanford's always had a great business, or if I tell them I have 25 – I have a coin that Stanford gave me. It's a Stanford Business School coin, and what happens is everytime I want to make a decision I flip a coin. So, I tell my manager, "Do you have a quarter?" "Yes" "Take your quarter out." "Okay" "Everytime you want to make a decision, and you're not really sure of it, I want to take your quarter out and flip it." He'll say, "Okay." I say, "Okay, when you flip the coin, how often will you be right?" He says, "Fifty percent." I say, "Good. I have this quarter that I flip also. So, if you call me and I flip my quarter, do you know how often I'm right." He says, "No." "Thirty percent of the time." I said, "Why the hell would you call me if you're right more often than I am?" And, after I tell these stories to them over the period of a couple of months, they get the message that I sincerely want them to run the business.

MICHAEL: Do you ask the manager to provide you any kind of reports or any kind of feedback as you're hands off?

ART: We get profit and loss, balance sheets, in the beginning. We'll get them daily if we can, and then weekly, and then we're going monthly after that.

MICHAEL: At what point will you get a call from a manager where he's just really stuck and he needs to ask you a question? What kind of situations would that be?

ART: It has happened so infrequently, here's the thing – the person that I normally have running the company has already run the company for five or ten years. He didn't really bug the former seller. In fact, he didn't show up. The last one I was working on down in LA, the owners came in once every six or seven weeks for a day when he wasn't out playing golf.

So, it just doesn't come up very often. Again, if you have somebody that you're paying a hundred and some thousand dollars a year to, or whatever the amount happens to be, you're paying him a substantial amount of money, you have a substantial manager who can make decisions and knows as much or more than you do. I own a lot of companies, but I can't say that I'm a better manager than the managers I have.

MICHAEL: Here's the question and a situation from one of my listeners, "A client has a company that is an offshoot technology. They want to sell it. It looks like a start-up, but have over five million dollars in purchase orders mostly from third world country government, but it is all the needed licenses and government approvals.

Manufacturing is done in China and done by a very good company, done on time in price. Net profit that is over 25 percent, after several phone calls, due diligences and other local governments, I can sign new contracts to at least five million more in the next 30 days. We need to raise three million used to purchase the license and patent in all current signed businesses. Please tell me where I can find investors or funds, not bank loans where we can develop funding?"

ART: All I need from you is a business plan. Now, the reason I ask people for business plans in the beginning when they're doing what you're doing is we can help even though it's basically a start-up coming because of the other things you have going on. But, keep in mind one thing, years ago I used to meet with people before they put together the business plan, and I found out after a couple of years that people are afraid of three things – death, taxes and business plans. In fact, most people would rather die or pay their taxes then put together a business plan. Of all the people over the years that I met before they completed a business plan, none of them ever put it together, none, which means they didn't get their financing and they're telling their grandchildren how successful they would have been if they had gotten the financing. The reason they didn't get it is because there's no business plan.

A business plan is a description of what you're doing. In other words, if you came to me and said, "We need three million." I can't take what you're telling me verbally if somebody else can whisper in their ear. What you need is that document and you put that document together, and if the thing makes sense and everything you've talked to me about, Michael, on this makes sense, you'll get your three million or more.

MICHAEL: Is there a recommendation that you could suggest to anyone who is afraid of putting a business plan together on how to do it or to get somebody to do it for them or work with them?

ART: There are people in all towns that put together business plans for five or ten thousand dollars. If you know how to use a computer or you like to go to the library, go down the library to the business section and most libraries not only have books on what goes into a business plan or samples of business plans, but they also have business plans on CDs that you can put on your computer. Now, if you don't want to do that and you don't like to go to the library, just go online, put "business plan" into your computer, and watch it exploder. There are a lot of companies out there that will give you samples of business plans because they're trying to sell you financing or something like that, just modify them.

All it is, is somebody's coming into invest, and if you were the investor coming in, what information would you want before you would make the investment. What you're doing is just spelling this out. In fact, if somebody else puts it together for you say, they're going to have a lot of disclaimers in there that they didn't check anything out and stuff like that, and the person that needs the business plan are going to have the due diligence themselves.

The main thing is keep it simple. Don't let this business plan freak you out because once you put together a business plan, you have a plan to move you're company forward. If you need any other financing or investors, it's a very small – it will take you a couple of hours to make changes in it and bring it up to date. It's a great, great tool, and everybody should do it.

MICHAEL: Why must investments from investors be a million minimum?

ART: Okay, let me go back over the years. Anybody that comes to me that wants 300,000 – 400,000 - I would tell them the same thing anybody will tell them, and that is if you need a couple hundred thousand or 200,000, you're going to have to go to a relative or a friend. Nobody's going to screw around with it. It's not worth doing.

The other thing is for about six months about ten years ago, we decided to go after people with less than a million dollars, and what we found is they wanted to earn four to five times the return that would be a normal return on a business. In other words, if we have 200,000, I want to have a million at the end of the year – something ridiculous like that.

So, over a six month period, we had a large company doing this at the time. I don't know how many people we worked with, but we couldn't even get close to putting one together. But, what we found is at about a million dollars investment, the investor is more reasonable. In other words, whatever the market rate is – in other words, if the person's earning seven percent on the money they're getting, they're getting about eight or nine on a deal, whatever it happens to be.

So, it's fair, and I want to tell you something, when you start to see returns you have to pay the investors compared to what you're paying for the business. You end up with an awful large percent of that company without putting up a lot of all of your money.

MICHAEL: Let's say there's an investor out there with money to invest. What's in it for the investor and are you open to expanding your investor contacts?

ART: Yes, I am open to expand investor contacts. What I'm really open to is I'm trying to find more people that need the money because say you and I work together Michael – the thing you're going to find working with different investors – I don't think any of them have any complaints except one thing that we have never have enough product. There's a lot of money out there, but very few projects that we work on because I'm not trying to set a record buying companies. So, we don't have enough product over the period of a normal year, but if somebody's interested in coming in as an investor, one thing they should keep in mind is they can get a pretty good return being an investor, but if they have over a million dollars and would like to own a company, the return will be 25-33 percent on their money there.

MICHAEL: A lot better.

ART: Yeah, yeah, that's a lot better, and that's on a managed company that's not going to drive you nuts, and we'll stick with you I mean, even if you own it yourself. If something goes wrong, we'll come in and solve the problem.

MICHAEL: If I want to buy a business, and I come through you and through one of your investors, and I acquire the business and there's problems, what are you going to do for me?

ART: We'll come in and solve it.

MICHAEL: Okay.

ART: I have a number of people that work for me that are in the consulting business, too. Also, we have owned three consulting firms. So, I have a lot of people available to do that, and also unless I'm very busy, I will take care of it because that's exciting to me. I mean, I spent all my life buying companies, and I don't really get to solve a lot of problems. So, when one comes up whether it's verbal or going on the scene, that's interesting to me because it's something different.

MICHAEL: Is this possible with a poor credit rating and a bankruptcy?

ART: Let me tell you something interesting – I don't care if the owner's carrying back financing and the bank's financing, I don't remember in the last 30 or 40 years anybody I was working with that filed bankruptcy had anybody check on them. The thing that upsets me everybody should check on the other person. What happens is if you have a poor credit rating or if you have a bankruptcy that's only going to be important to the owner starting financing.

What you're going to find is, I hate to this, they don't check. Do they occasionally? Probably, I'm not aware of it, but I don't remember the last time that came up, but I do remember every week talking to people that filed bankruptcy or had terrible credit, and it's not important because what happens is you're focusing on you the buyer. Don't start a business. Don't buy some little donut shop, buy something a little larger, and the people coming in, the people putting the money up, the people checking are going to see the business, not you. You can be a flake today and just filed bankruptcy and have no money and don't pay anybody. Tomorrow, when you take over that business, you can go out and buy it. As soon as you go into escrow, they'll deliver a new Mercedes to your house. You can go out and buy a ten million dollar house. Why? Because you now have taken on a persona of that business you bought. You are now that business. You are now a person making X number of dollars a year, not some person that screwed up.

MICHAEL: What is the maximum you guys can get from investors? I know the minimum is a million dollars. So, what's the maximum?

ART: That's an interesting question. Again, I don't know a maximum. I know the areas we normally work in. The people invested with me in Mexico, we have about 72 million dollars left of investors that bug me every month. They call me every month, and ask me when I'm going to get off my behind. Also, at our national marketing meeting real estate, we have tens of millions available. If somebody needed a hundred million dollars, we'd have no trouble raising it from the people that we have now. I have a son that is a vice president of with FBR, one of the big IPO firms, and if you need money beyond that, my son – I've already referred things to him, IPOS, they also went public and they're worth billions. All we need is a business plan. In other words, don't come to me and say, "We need the following." We need a business plan first so you don't waste his time. Once you do that, I know, this year through March he had put together three deals for over 300 million each. He had told me yesterday he had seven more in the hopper.

MICHAEL: How many businesses do you own Hamel? How many years have you been in business successfully? What's been in your involvement in businesses with brokering and real estate over the years?

ART: Well, the thing that's interesting is up until a couple of years ago, Michael, I used to tell people, "I've been in business 30 years", and I've learned that people say, "How can you say you've been in business 30 years? I've known you almost 40, and you've been in business every since I knew you pal." I then moved up to 40, and then probably about a year or two ago, somebody said to me, "Why don't you quit lying about your age?" I said, "What are you talking about? I don't lie about my age." They said, "Why don't you tell people how long you've really been in business because I knew you back in college, and I knew you back in New York, and you've been in business over 50 years." So, it's been embarrassing doing that because not everybody realizes I'm not 37.

MICHAEL: How many businesses have you owned?

ART: You know, back when I was n the seminar business, I was asked that ten times a week, and we actually knew. All I can tell you is I had either 25 or 30 in the first three years at the end of that period. The last time I checked, and this is just an average, I was up less than 200, but I was approaching 200.

MICHAEL: Do you buy a business with the intent of selling it down the road, or just for the reason of profits?

ART: What happens is when you're bringing investors in, we have a pro forma for what they're looking at. If they're looking at a return and they want a return of X number of dollars or percentage, they usually look at pro forma for five years, and as long as they're getting their return plus extra over that five year period, they'll do it.

So, most of them will think about staying for five years, but of all the ones that have come in with us, none of them have really left because what they do is if they do decide to get out after four or five years, they go into another program we have, another business we're buying.

MICHAEL: Good. Tell me about a little bit of background about the seminar business back in the '80s - how you got into that and what it evolved in and then how you eventually got out of it.

ART: Well, this is back in the ‘70s as a matter of fact, the early ‘70s is when I got involved in the business. Actually, I had a friend of mine who was a big seminar person here in San Jose.

MICHAEL: Can I ask who he was?

ART: Yeah, Cliff Reader. He was very well known in real estate, nationally and we used to go out with our wives all the time, and I would tell him many business stories, but you see he and my wife and his wife would laugh hysterically and I wouldn’t. I didn’t think they were funny, but he’d ask me questions about that. So, he finally talked me into teaching, and I told him I would teach for five years. Again, this was only part time because my love was buying my companies which I did for a whole 15 years.

MICHAEL: So, he was doing seminars already, and he asked you to come in and kind of add to it.

ART: He was doing it in real estate, and he figured we needed courses in business for people. So, in the beginning we taught these classes to nothing but real estate exchangers and other people in real estate.

MICHAEL: What’s a real estate exchanger?

ART: These are the people who do 1031 exchanges or work on creative techniques to sell and exchange real estate. They’re international and they’ve been around a long time. So, I got them to come to the program with these national groups supporting me, and then after a couple of years, I basically ran out of people. So, somebody suggested Bob Seal, and actually, Al Lowery who was teaching classes – you know, Larry Nickerson? Al said, “Why don’t you teach a business class nationally with buyers?” And, I said, “Why? He said, “Because the competition that I have is really tough, and I know you and I know you’ll be fair.” So, he basically talked me into it and spent time in his Reno office showing me all the ins and outs. And, we started off small, and the last few years our classes were running three or four hundred per class.

MICHAEL: Were you traveling all over the country doing them?

ART: Yeah, well we had other people that were teaching too. The problem I’ve had, I’ve always had too much success. I never had an instructor last more than three months. I would just get him trained, somebody would offer him a business deal in the seminar, and they would be gone.

MICHAEL: Oh, I see.

ART: I had the same thing in brokerage because we had brokerage offices. We were in the seminar business. We tried to make sure that we had the highest success rates for our graduates. We also had brokerage offices that we would work with anybody. In other words, brokerages would qualify you and give you a hard time. So, we had an office in Seattle, one in Portland, San Jose, LA and Houston.

MICHAEL: That would assist your students.

ART: Right, but they also, they helped anyone else that wanted help, but we also then have marketing sessions were buyers, sellers, brokers would get together once a month in each one of those cities, and we ran those, and then what we would do, we'd put on nationals which would be a three day meeting where buyers, sellers and brokers would get together to sell businesses and the first designation in business brokerages was actually the company I formed called "Service Side Business Counselors" which is probably 35 or 40 years ago. Groups today that are giving out designations and business appraisals, business whatever are all the original people from that group that I founded.

MICHAEL: Wow, did IRS adapt any of your teachings?

ART: Oh yeah, we were an IRS approved program for many years.

MICHAEL: Is it hard to get an approval from them?

ART: What they did is they sent people to the class, and we then became part of their continuing education program. Once we got to that, we had a number of people going to our class up to the head of their fraud division from – which really made me nervous teaching in Washington, D.C., and the guy from the fraud division was sitting in the front row, and everytime he'd lean forward – I still remember he had a pale blue three piece suit on – everytime he'd lean forward, I could see his holster and gun, and I'd probably gulped, and when I got to Sunday which is when we used to cover taxes, I was really nervous, and when it was over he came up and it was break and I turned to him and I said, "How did I do on the tax section?" Without smiling he said, "I didn't arrest you did I?" I said, "Okay."

MICHAEL: That's – oh wow.

ART: We're also an IBM approved plan. It's the husband and wife at IBM where in the last two years before retirement, IBM would pay their way to our seminar. This is before IBM was laying off people.

MICHAEL: Tell me about your infomercial and the sales of your seminar through that.

ART: We used to have a lot of different things to promote because we put on a free lecture to promote the class in an area. So, we'd put on three, four, five of them. Somebody came to us and said, "We're putting on these little half hour programs and 15 minute programs. Why don't you put on a one hour program to sell your cassettes?" So, I went on this thing with – I forget his name. He was a game show host, very famous. He's still very famous. So, I went down there the day before. We had a full studio. I mean this is not cheap. I mean this is a complete movie studio that we had for this one hour program.

I went over this with him for two or three hours the day before. We sat down. The camera started to roll. We taped the whole thing with no cuts, with no mistakes. Could you imagine? That thing went on and what happened is we ran into a guy that owned the Shopping Network, some billionaire from New Jersey, and every morning after the Shopping Network went off the air at three a.m., they would put our one hour program on. That was the good news. We sold lots of cassettes, thousands of them per week. In fact, it was the biggest seller that they ever had.

The problem we had was I couldn't go anywhere in this country. I had a mustache at the time. Everyone would say to us, "You're the guy with the mustache." They couldn't remember my name or anything else. "I saw you on the Shopping Network". I wasn't really on the Shopping Network, but almost. In fact, probably because of us, you see what they do on the Shopping Networks now. They have people like us as part of the Shopping Network whatever they call it.

MICHAEL: So, you sold thousands and thousands of the same courses of the inventory I bought from you.

ART: Well, that's how we had any left for you because what happened is my wife had more trouble collecting from this guy. Here's a guy a billionaire, and we didn't call through his office. My wife had to call him at his house every month to bug him to get paid.

MICHAEL: So, he wasn't paying you?

ART: Well, he would, but he was so late and he was such a pain in the ass, and we'd ship a thousand at a time, and we just quit doing it, and that's how we have the ones still left that we ended up turning over to you.

MICHAEL: So, basically, when he was doing it, what ended it? It just ran it's course?

ART: Do you mean with him?

MICHAEL: Yeah.

ART: We told him we weren't going to work for him anymore.

MICHAEL: Okay.

ART: You have to realize that's a lot of money. We were making a lot of money on that, but compared to everything else we were doing, it wasn't enough to justify. I probably could have turned it over to somebody else or my wife still would be doing it, but I was trying to get her involved in business at the time.

MICHAEL: One last question and we'll wrap it up. What do I have to do to qualify for help with you and your investors?

ART: Okay, first of all, if you have a business, a larger business that requires at least a million dollars, either for the complete amount or for part of it that's over a million. If you're at the point where you're about ready to buy the company, in other words, I don't want somebody that just now thinking about it or might do it, or still working on small stuff. You have to get up to the point where you have something available just like you referred me to a person in the Midwest a couple days ago. I'm working with him now.

What happens is, he has found a large company, a 30 million dollar sales company back in Chicago which we're now putting together, but the information is being sent to me. So, once you're at that point, I can work with you. There's no charge. There's nothing.

Now, if you come to me and you're not at the point where you have a large business, or you're really not doing anything, you just want to talk about it, I'm going to charge $150 an hour. I don't want your money. What I want you to do is get off your duff and do something. So, what happens is if you sign one of those agreements, I then will work with you at any level you want. I'll talk to you, work with you personally hour after hour. When you finally go out to buy this and we provide the financing, we'll refund all your $150 time whatever hours. So, you get all your money back. We used to do that also with the brokerage business. When we had somebody coming in that just wanted to talk, years ago we would charge them so much an hour and then when they bought the business, we refunded all the money they paid us because our goal wasn't to talk to them. Our goal was to get them to buy a company, and that's what we did.

MICHAEL: Can you think of any better investment than buying a business?

ART: Well, let's put it this way. If you pay all cash on a business, and you're the principle, it's your money, you're going to get a 25-33 percent return. If you get any financing at all, these are talks I give all the time, the cap rate on the average business with some financing is about 60 percent. These are talks that I'm usually giving to real estate people.

MICHAEL: For people who aren't real estate people, explain what the cap rate is.

ART: What you're doing is you're getting 60 percent of your money back every year.

MICHAEL: Okay.

ART: So, if you invest 100,000 dollars, you're going to get 60,000 back a year. I mean, on real estate you invest a hundred you're going to get 10,000 back. So, it's six times what you normally get, but it's more than that because for those of you math people listening to this, mathematicians or engineers, it's infinity because the amount that you normally invest with investors is as close as you can get to none. On the businesses that I buy now, in the last 25 years, I put up money for attorneys and CPAs which you don't have to do because they'll ride along with you. I may have expenses for traveling to different cities, but everytime your investors are told one thing, "At close of escrow, I'm pulling back all the money I invested." So, how much have I invested in the last 25 years? Nothing. I've invested time. I've invested money, but I've gotten the thing back at the close. I've never had any investors complain about the fact that I'm pulling the money back. So, since they know that, they know that their money is putting the deal together.

Okay, let me tell you why we work with real estate investors. Number one – I go to the meeting. I'm very well known for 30 some years. Most of these people have been through my seminar so, we have a relationship there. I've been pitching this at real estate meetings probably for 30 years now, and all we do is we say to them, "You have free and clear an apartment building in Chicago. It's free and clear. You're cap rate is ten percent. In other words, the thing is worth three million. You're earning a ten percent return on it. If you invest in this business, we'll give you a 20 percent return." Right? Which is 20 percent more than they're getting now."

So, we're going to give them a 20 percent more return. The average business has more growth than real estate. So, we're going to give you more growth, and the minimum growth we ever have is ten. In all the companies that we have in Mexico, we did not have one year where we did not increase our sales and profit 25 percent, which you can do if you concentrate on it. Okay, but we're talking to them about ten.

So, first of all, you're getting more money return. You're going to have more growth, and the other thing is comparable risk. Those are the only three things you have to think about with an investment. On comparable risk, although people are always saying that real estate is very safe, and it's the way to go, if you and your attorney and CPA go out to the market and check on the failure rate of the companies that we're working on, you'll find that our failure rate on every one of the ones I work on is less than anything you can do in real estate. So, you have three things – more return, more growth, comparable risk.

MICHAEL: Let's talk about that comparable risk. I mean, just from me hearing your answer to that, real estate values you have no control over, a business you have a lot of control over, and do you think that plays a part in less risk with the businesses that you're working with compared to real estate?

ART: Well, one of the things you have with business in the category we're in maybe around ten or 20 years, manufacturing just on its nature because it doesn't have the failure rate that other businesses have or real estate has. You see for years, real estate brokers were out there saying that there's no downside, there's no danger, and you could have management free real estate. You talk to any one in this country that owns apartment buildings and stuff like that, there's no such thing as management free.

Our businesses are management free. Why? Because we have managers there that don't bug us. We have less management problems then the average person with real estate, you know the people at our meetings that have real estate, the brokers or their clients do. Over the years, probably 99.9 percent of the people I work with that own these million dollar pieces of real estate got their money from the business they own.

So, the problem I had at those meetings was not talking to the investor. It's getting by the broker because the broker doesn't understand business. So, when I bring up business at a meeting although it's making a couple million dollars a year, they're very nervous about it. So, I always say, "Look. You have a client. He has his property. Why don't we go back to New York and sell it?" It cost me a lot of money flying all over the country, but the thing is once I get there the broker finally realizes, "My god, I almost killed a good deal here. My seller and Hamel get along perfectly." Why? Because they're both business owners.

So, the difficult thing is getting people off their duff to go out and find a business, and go out and go as far as the can. Now, once they get to the point even before they start negotiating, they have it. They're ready to go. If they're at the frame of mind they want that business and need at least a million dollars, again, we're willing to help them, no fee.

MICHAEL: *I hope you learned a lot from this interview with Arthur Hamel. If you are interested in buying a business and fit the criteria that Art described in this interview, please contact Michael at 858-274-7851 that's 858-274-7851, or email arthamel@hardtofindseminars.com , that's arthamel@hardtofindseminars.com*