Tim and Brad Larson:
Finding and Evaluating Business Opportunities

Tim Larson, lifelong entrepreneur and business owner, sat in his office on the afternoon of Friday, April 23, 1993. Across from him sat his son, Brad, age 33. On the desk between them was information on four companies: Landscape Products, Inc.; Fairway Outfitters, Inc.; Richmond's Premium Snacks, and Teletech Systems. Three months earlier, Tim, age 61, and Brad had solicited responses from Midwest business owners who were interested in selling their companies. Over 75 owners had responded.

Of the 75 responses, Tim and Brad had selected 10 companies they felt were promising. In March, they had physically visited those 10 and gathered detailed information on each. On Wednesday, April 21, they had narrowed the list of 10 down to the four finalists. Over the next couple weeks, Tim and Brad hoped to decide which of the four they were most interested in purchasing.

Background on Tim Larson

Tim Larson had been involved in business most of his life, though he had never worked for another employer. Following graduation from high school in Cedar Rapids, Iowa, Tim joined the Air Force. After four years in the Air Force and an assignment in the Korean war, Tim attended college, earning both a bachelor's degree and an MBA. Tim had decided long before, however, that he wanted to be his own employer. He said,

> I knew very early in my life that I wanted to be self-employed, but I came from a very poor family, so we didn't have any money. That's a bad combination. You want to get in business, but then you don't have the bucks to finance it.

One option Tim had was to start his own business, but he didn't consider himself to be a highly creative person. He continued,

> One key for a starting entrepreneur is to know what you are and what you are not. I knew what I was not. I was not a creative guy who could come up with lots of new products and ideas. That wasn't my style. I'm a strong administrator and a strong motivator; I'm hard working and driven. I wouldn't do well having to come up with new ideas all of the time. Others are good at that. I'm good at managing things and making them successful.
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> That's why self-analysis is essential for anyone who wants to be self-employed. You need to know your strengths well enough to know what your strategy should be. Quite honestly, you also need to ask yourself some hard questions. Everyone wants to be self-employed, but very few people actually *should* be. Many people are better off working for someone else. The buck stops with you, and you really need to know what you are best at.
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> I knew I wanted to be self-employed, and I was confident I could succeed as an entrepreneur. I also knew what my strengths were. Therefore, my strategy was to find another company to buy. I didn't have any money, however, so I had to find a company that was really struggling—I needed to find a turn-around situation where I could buy the company for almost nothing and then try to make something out of it.

Initial Company Search

Tim was aggressive in his search for a company to purchase. He explained,

> I wrote 250 letters to attorneys, CPA firms, and banks. In those letters, I indicated my strengths and my desire to work for___and then purchase___ a small company that was struggling, but that could be turned around with hard work and professional management.
>
> I wanted to find a company where the owner was older but didn't have any children___no heir apparent___so that I could come in, work for him, and get his confidence. Then I would buy his equity with cash flow generated from the business. I ran ads in every major paper from the Mississippi to the Rocky Mountains. Those ads said, in essence, "Young, aggressive MBA, with limited financial resources, looking for opportunity for heavy sweat equity." From those ads, I got 400 responses and I physically visited 104. That was the greatest experience in the world___looking at balance sheets, interviewing entrepreneurs, etc. Even so, because I didn't have much money, it took five years to find a company that I could purchase where the seller provided the financing and where the assets of the company secured the loan.

Tim finally found a business in Kansas City. Over the next 30 years, he had owned numerous types of businesses in various industries.

Brad Larson's Involvement and the Recent Search

Five years earlier, in 1988, Tim had sold his last business and gone into semi-retirement. He had had no intention of purchasing another business until his son, Brad, had approached him in October 1992. Brad had received his MBA from Harvard in 1988 and was an operations consultant for Price Waterhouse in southern California. However, Brad wanted to get out of the consulting business and didn't want to raise his family in southern California. Brad was bright and possessed the experience and skills necessary to succeed in running a business, but he did not have the financial resources to purchase his own business. As a result, he approached his father about helping him find a company to purchase. Tim explained,

> The plan was for me to provide the up-front capital and some credibility with my experience in purchasing and operating successful businesses. Meanwhile, Brad would get good experience running the business. He had good experience from his consulting, but he had never had P&L responsibility. After two or three years, I would then turn most of the responsibility over to Brad, and I would take on an advisory role.

Recent Search Strategy

To solicit responses, Tim and Brad had placed an advertisement in the Sunday editions of papers in Kansas City, Omaha, Minneapolis, St. Louis, and Des Moines. A reproduction of the advertisement is shown on the next page. The advertisement ran in each paper twice, two weeks apart, in January 1993. The total cost for running the advertisements was approximately $2,600.

Wanted!
Business to
Buy

Distribution
Manufacturing
Food Processing

Can be a turn around situation.
We have a financially responsible
client anxious to buy.
Excellent management

Please contact:
Kent Brown

Arthur Andersen
& Company

Kansas City
(816) 534-8608

Using Kent Brown at Arthur Andersen as a contact was an important element in the advertisement. First, using a recognized firm such as Arthur Andersen gave the solicitation credibility. "Solid prospects generally won't respond to a blind ad," Tim explained. Second, by using Arthur Andersen, Tim and Brad were able to maintain their own confidentiality. Third, because Tim and Brad provided Kent with the criteria they were looking for in a company, Kent was able to screen out companies that did not match the Larson's interests and strategic plans. Tim said,

> We had some loose guidelines that we gave to Kent. Those guidelines helped Kent identify early on whether or not the company fit our needs.
>
> First, any company that wanted 100 percent of the purchase price up front was rejected. We wanted to be able to make a down payment of 25-30 percent of the purchase price, then use the assets of the company to borrow the rest of the money. With my assets, I could probably offer between $700,000 and $1.4 million up front, and we were looking at a total purchase price of no more than $4 to $5.5 million.

> Next, we gave Kent a list of our lower priorities. These included the following:
>
> (1) restaurant chains
> (2) service companies
> (3) businesses with a poor balance sheet—a poor income statement was acceptable, but a poor balance sheet was less acceptable
>
> Finally, as the advertisement indicated, we were most interested in distribution, manufacturing, and food processing companies.

One savings Tim and Brad enjoyed was that Kent Brown was a long-time friend of Tim's. As a result, Kent agreed to charge the Larson's only for his out-of-pocket expenses, with the agreement that, if the company Tim and Brad purchased were successful, Arthur Andersen would get to do the annual audit work. This was a significant savings for Tim and Brad, since Kent's fees were in the range of $200-250 per hour. Tim said,

> Using Kent at Arthur Andersen was very helpful, but it would be difficult for a student coming out of school to use a Big 6 firm. Even so, a student could use a smaller CPA firm, a lawyer, or a bank officer to gain credibility in the search process.

Analysis of the Finalists

Tim explained what he felt were the primary elements in analyzing any business:

> From my experience, I've found that there are five essential steps involved in buying a business:
>
> First, you need to identify why the owner is interested in selling the business. What is his or her motivation? For example, if the owner is older and wants to retire, or if he or she is experiencing health problems, those might be legitimate reasons. On the other hand, owners may have unprofitable businesses that they simply want to pawn off. That's why it is important to determine the real reason the owner wants to sell.
>
> Second, you need to do a sound financial analysis. What trends is the business experiencing? In which direction is the business headed? What has happened to the balance sheet over time? Do they have any retained earnings? Have they been profitable historically? Of these, the trend and the balance sheet are probably most important. A poor income statement can often be turned around with strong management, but a poor balance sheet reveals the overall strength of the company.
>
> Third, it is important to perform a thorough analysis of the company's market and competitive position. You have to ask what you would have to do to stay alive. You need to see if there are any niches where you can be profitable. Also, since most people are generally looking at purchasing smaller companies, you need to look at the larger competitors in the industry. Are they going to leave you alone, or are they going to crush you if you start to be more profitable?
>
> Fourth, consider the people involved in the business. Do you have a solid player, or is the owner a promoter? Personal values are important. If you can, talk to the company's customers. Find out what the customers think of the owner and the company.
>
> Fifth, consider the state of the company. If you are looking at a manufacturing company,

> find out whether it is on the cutting edge of technology or whether its equipment is virtually obsolete. How is the company positioned to compete in the future?
>
> Once you've analyzed each of these factors, you need to be able to negotiate a deal you can live with. In the negotiation process, you need to be careful, because you can fall in love with the idea of owning a certain business, even when the business might not be a good deal. You need to remain objective in the negotiation process.

Explaining the purchasing strategy Tim used throughout much of his career, Tim continued,

> I usually look to pay 25-30 percent of the purchase price up front, and then have the seller finance the rest of the deal. I use the assets of the company to secure the loan and use cash flow from the operations of the company to service the debt.
>
> You need to be able to offer enough money up front that the seller is going to have confidence in your ability to service the balance of the debt. However, many companies don't want to finance the rest of the purchase price. That's one way to figure out if the company is any good. Aside from simply wanting all of the money up front, there are only a few reasons the seller won't want to assume the debt and let you service it through company cash flow. The first is that the company really isn't that strong, and the seller doesn't have confidence that the company will generate the cash flow to meet the debt obligations. The second is that the seller doesn't have any confidence in you.

The Four Finalists

Below is summary information on the four companies Tim and Brad selected as finalists. Financial information on the four companies is provided in exhibits 1-4.

Landscape Products, Inc.

Landscape Products, Inc. was a manufacturing and retail business based in Omaha, Nebraska. It produced landscaping materials such as decorative bark and rock, as well as mulch and steer manure. A member of the board of directors at Landscape Products said the company also had "several other products that have tremendous potential for the future, one of which is compressed fire logs." Most sales were at the wholesale level.

In April 1993, the company was operating at full capacity, running three shifts a day, six days a week. There were 110 employees on the payroll, though seasonal production caused layoffs during certain times of the year. Labor was easily accessible and fairly inexpensive at $5 to $9 per hour.

As of April 1993, there was only one full-time, in-house salesperson. This person accounted for 50 percent of total sales. A brokerage firm, which was a 25 percent partner in the business, accounted for the other 50 percent. Landscape Products anticipated significant growth and was looking to hire a second salesperson before the any final negotiations might take place with the Larsons.

Landscape obtained materials from twelve lumber mills. Normally, these mills closed down for six weeks in November and December. However, these mills had been closed for nearly twice that long at the end of 1992. As a result, sales for the six months ending February 28, 1993 were lower than had been expected (see exhibit 1). David Andrews, Landscape's president and founder, explained that, as a result, fiscal year-end figures would likely be similar to the previous year's results, rather than higher, as he had originally expected.

David Andrews and his brother, Ryan, had started the company in 1981. Both were in their mid to upper 50s and were interested in an early retirement. Each owned 35 percent of the company. David's son Neil owned another 5 percent of the stock. Neil managed the day-to-day operations. He wanted to remain with the company and, if possible, increase the amount of stock he held in the company. David Andrews felt the value of the company was $5-$7 million.

Fairway Outfitters, Inc.

Fairway Outfitters, Inc. was a Kansas City based distributor of golf-cart parts and accessories (for example, bolts, rivets, seat covers, windshields, tops, etc.). As of April 1993, it had approximately 130 customers___most of whom were golf-cart manufacturers___throughout the United States and Canada. In a spirit of cooperation, the president of Fairway Outfitters, Inc. had given the Larson's his complete customer list. Initial probing by Brad indicated that the company's customers were satisfied with the company. In fact, Fairway Outfitters received many new customers each year from referrals.

The company had been started in 1990 by a former marketing director for a regional sporting goods distribution company based Kansas City. Following his own entrepreneurial spirit, he had started Fairway Outfitters out of a small, rented warehouse. Since then, Fairway Outfitters had experienced significant growth, and the owner predicted that such growth would continue for the next few years. Nevertheless, because it was a relatively new company, it was still small, with only two full-time and four part-time employees.

The founder indicated that a Florida land developer and business contact had offered him the opportunity to manage three private golf courses, but that to accept the position, he would need to sell Fairway Outfitters or turn management of it over to someone else. Since there were few employees at the company, and since none of them had the experience necessary to manage the company, the founder had decided to sell. He felt the business was worth $3-$4 million.

Richmond's Premium Snacks

Richmond's was a St. Louis based manufacturer of salty snacks. Between 1985 and 1992, the salty snack industry had grown at an average annual rate of 7 percent. During the same period, Richmond's had grown at an average annual rate of 18 percent. Thus far, the company had concentrated its sales efforts in the Midwest, though the company was in the process of expanding sales. Sixty percent of Richmond's sales were to ten key accounts, the largest of which was Kmart. Sales are highly seasonal, with 70 percent of sales occurring between September and December.

The company currently had one plant in St. Louis. The plant size had been increased in 1987 and the current management believed the plant could support sales of $14 million. An increase to $20 million would cost approximately $500,000.

The company had been started in the late 1950s by Brian Richmond. In the 1980s, two of Brian's sons had also started working at Richmond's, both with the hope of one day running the company. Brian was still the majority owner of the company, but his sons had attempted to take over the business in 1991. The situation had deteriorated to the point where, for the health of the business, Brian felt it best to sell Richmond's to a third party. Brian was asking $2 to $2.5 million for the company.

Teletech Systems

Teletech's primary product/service was Shopper's Express. Shopper's Express allowed individuals to complete their grocery shopping via telephone. Individuals would purchase a hand-held bar code wand costing approximately $29. This wand attached to the back of an ordinary telephone. Individuals would then pick up a catalog of items from a participating grocery store. This catalog would list the items sold in the store, along with the item's bar code. Participating stores would have to purchase a desktop computer with a modem, a software program designed to accept and interpret the information received over the phone, a dedicated phone line, and a laser printer. Participating grocery stores would also have to develop the catalogs, but these could be developed easily and inexpensively using the software and the laser printer. (An example of a page from the test catalog is provided in exhibit 5.)

To order items, the shopper would dial the telephone number given in the catalog. He or she would then swipe the bar code wand across the code for the item he or she wished to buy. A moment later, an automated voice would indicate the price of the item through the telephone receiver. If the shopper wished to purchase the item at the given price, he or she could enter the number of items desired, followed by the pound sign. If the shopper did not wish to purchase the item at the indicated price, he or she pressed the star sign and went on to the next item. Once familiar with the process, most shoppers could complete a week's worth of shopping in 15 minutes.

Once the order was complete, the computer program printed a copy of the order. An employee at the store then gathered the items from the store and prepared the order for delivery or pick-up.

Eight people were involved with developing the product. It was anticipated that 100 test units would be ready to test within three months. Two grocery chains, Stop-N-Shop and EconoFoods, were willing to participate in the pilot phase. Actual introduction to the market was eight months away. The inventor of the business idea anticipated that an additional $300,000 was needed to bring the product to market, ignoring marketing costs. The technology was not complex, though Teletech had a patent pending on the hand-held bar code wand. The founder of Teletech was asking $4-$6 million for the business or considering other financing alternatives.

Exhibit 1

Landscape Products, Inc.

Income Statements

	Year-Ending Aug. 31, 1992	Six Months Ending Feb. 28, 1993
Net Sales	$6,950,419	$1,787,507
Cost of Goods Sold	$5,141,291	$1,301,857
Gross Profit	$1,809,127	$485,650
Expenses		
Finance Charges	$154,319	$76,471
Depreciation	$24,853	$95,244
Salaries, Wages	$295,023	$126,881
Nonitemized Exp.	$310,463	$424,414
Total Expenses	$784,658	$723,009
Net Profit from Operations	$1,024,470	($237,359)
Interest Expense	$277,501	$135,647
Earnings (Loss) Before Taxes	$746,969	($373,006)
Taxes	$216,085	($108,903)
Net Income	**$528,884**	**($264,103)**

Balance Sheets

	As of Aug. 31, 1992	As of Feb. 28, 1993
Current Assets		
Cash	$192,572	$63,326
Receivables	$702,592	$1,296,050
Inventory	$996,100	$915,970
Prepaid Expenses	$22,796	$106,558
Total Current Assets	**$1,914,059**	**$2,381,904**
Fixed Assets		
Plant and Equipment	$3,311,351	$2,673,380
Accumulated Depreciation	($819,917)	($784,090)
Land	$96,419	$68,919
Total Fixed Assets	**$2,587,853**	**$1,958,209**
Total Assets	**$4,501,912**	**$4,340,113**

	As of Aug. 31, 1992	As of Feb. 28, 1993
Current Liabilities		
Prepaid Sales	$5,467	$1,132
Accounts Payable	$488,327	$521,976
Interest Payable	$12,279	$9,628
Salaries Payable	$454,388	$355,270
Notes Payable	$477,331	$337,957
LT Debt, Current Portion	$295,606	$277,482
Total Current Liabilities	**$1,731,407**	**$1,503,444**
Long-term Liabilities		
Notes Payable	$758,450	$1,139,458
Deferred Taxes	$100,004	$100,004
Total Long-term Liabilities	**$858,454**	**$1,239,462**
Stockholder's Equity		
Capital Stock	$667,923	$667,923
Treasury Stock	($91,986)	($91,985)
Retained Earnings	$1,336,115	$1,021,269
Total Stockholder's Equity	**$1,912,052**	**$1,597,207**
Total Liabilities and Equity	**$4,501,912**	**$4,340,113**

Exhibit 2

Fairway Outfitters, Inc.

Income Statements

	Year-Ending Dec 31, 1991	*Year-Ending Dec 31, 1992*
Net Sales	$987,140	$1,157,787
Cost of Goods Sold	$525,749	$545,929
Gross Profit	$461,391	$611,858
Expenses		
Depreciation	$31,716	$20,561
Salaries, Wages	$85,539	$92,727
Rent	$62,769	$78,210
Nonitemized Expenses	$124,975	$143,682
Total Expenses	$304,998	$335,180
Net Profit from Operations	$156,393	$276,678
Interest Expense	$7,242	$10,027
Earnings (Loss) Before Taxes	$149,150	$266,652
Taxes	$52,203	$93,328
Net Income	**$96,948**	**$173,324**

Balance Sheets

	As of Dec 31, 1991	*As of Dec 31, 1992*
Current Assets		
Cash	$769	$12,695
Receivables	$63,473	$88,705
Inventory	$32,791	$70,318
Total Current Assets	**$97,032**	**$171,718**
Fixed Assets		
Net Plant and Equipment	$40,637	$90,130
Other Fixed Assets	$18,063	$17,674
Total Fixed Assets	**$58,700**	**$107,804**
Total Assets	**$155,733**	**$279,522**

	As of Dec 31, 1991	*As of Dec 31, 1992*
Current Liabilities		
Accounts Payable	$110,923	$83,519
Taxes Payable	$7,160	$3,974
Salaries Payable	$1,301	$1,301
LT Debt, Current Portion	$6,689	$22,443
Total Current Liabilities	**$126,072**	**$111,236**
Long-term Liabilities		
Long-term Debt	$0	$23,103
Total Long-term Liabilities	**$0**	**$23,103**
Stockholder's Equity		
Common Stock	$1,375	$1,375
UTI	($137,621)	($110,136)
Retained Earnings	$163,907	$253,944
Total Stockholder's Equity	**$27,661**	**$145,184**
Total Liabilities and Equity	**$155,733**	**$279,522**

Exhibit 3

Richmond's Premium Snacks

Income Statements

	Year-Ending Feb 29, 1992	Year-Ending Feb 28, 1993
Net Sales	$10,046,735	$10,469,119
Cost of Goods Sold	$7,095,092	$7,443,488
Gross Profit	$2,951,642	$3,025,631
Operating Expenses	$2,157,192	$2,134,201
Net Profit from Operations	$794,450	$891,430
Misc Income	$29,238	$34,984
Interest Expense	$419,924	$371,489
Earnings (Loss) Before Taxes	$403,765	$554,925
Taxes	$162,124	$223,608
Net Income	**$241,641**	**$331,317**

Balance Sheets

	As of Feb 29, 1992	As of Feb 28, 1993
Current Assets		
Cash	$32,211	$121,815
Receivables	$368,598	$352,395
Inventory	$500,159	$985,523
Misc Current Assets	$6,016	$50,809
Total Current Assets	**$906,983**	**$1,510,542**
Fixed Assets		
Net Plant and Equipment	$3,045,761	$3,142,035
Other Fixed Assets	$107,026	$73,297
Total Fixed Assets	**$3,152,787**	**$3,215,332**
Total Assets	**$4,059,770**	**$4,725,874**

	As of Feb 29, 1992	As of Feb 28, 1993
Current Liabilities		
Accounts Payable	$212,651	$416,514
Taxes Payable	$187,055	$0
Accrued Expenses	$199,233	$123,005
Line of Credit	$0	$475,324
LT Debt, Current Portion	$140,427	$152,375
Total Current Liabilities	**$739,366**	**$1,167,217**
Long-term Liabilities		
Long-term Debt	$1,986,419	$1,825,478
Deferred Taxes	$155,265	$223,142
Total Long-term Liabilities	**$2,141,684**	**$2,048,619**
Stockholder's Equity		
Common Stock	$8,663	$8,663
Less Treasury Stock	($519,578)	($519,578)
Retained Earnings	$1,689,636	$2,020,953
Total Stockholder's Equity	**$1,178,720**	**$1,510,037**
Total Liabilities and Equity	**$4,059,770**	**$4,725,874**

Exhibit 4

Teletech Systems: Shopper's Express

Projected Income Statements

	First Year	*Second Year*
Net Sales	$562,031	$2,048,749
Expenses		
Salaries	$377,713	$650,788
Other Expenses	$332,778	$812,816
Net Profit from Operations	($148,459)	$585,144
Interest Expense	$6,876	$3,438
Earnings (Loss) Before Taxes	($155,334)	$581,708
Taxes	($20,347)	$215,232
Net Income	**($134,987)**	**$366,475**

Projected Balance Sheets

	First Year	*Second Year*
Current Assets		
Cash	$13,542	$317,372
Total Current Assets	**$13,542**	**$317,372**
Fixed Assets		
Equipment	$30,525	$30,525
Accumulated Depreciation	$4,428	$10,533
Total Fixed Assets	**$26,098**	**$19,993**
Total Assets	**$39,640**	**$337,365**

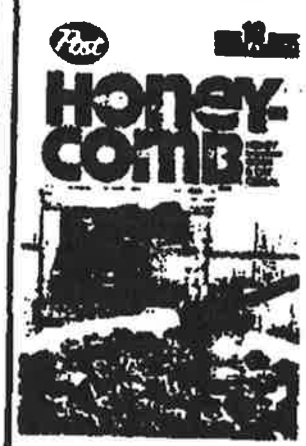
	First Year	*Second Year*
Current Liabilities		
Short-term Debt	$68,750	$0
Total Current Liabilities	**$68,750**	**$0**
Long-term Liabilities		
Long-term Debt	$0	$0
Total Long-term Liabilities	**$0**	**$0**
Stockholder's Equity		
Retained Earnings	($29,110)	$337,365
Total Stockholder's Equity	**($29,110)**	**$337,365**
Total Liabilities and Equity	**$39,640**	**$337,365**

Quaker Cereals

Life Cereal	12 oz box
Life Cereal	20 oz box
Instant Oats	6 single serving packets
Puffed Rice	14.5 oz bag
Cinnamon Life	12 oz box
Cinnamon Life	20 oz box
Puffed Wheat	14.5 oz bag
Oat Bran	20 oz box
Cap'n Crunch	20 oz box
Cap'n Crunch with Crunchberries	20 oz box
Cap'n Crunch with Peanut Butter	20 oz box
Quaker Natural - regular	23 oz box
Quaker Natural - Raisins	24 oz box
Quaker Natural - Nuts	23 oz box
Quaker Natural - Raisins and Dates	24 oz box
Quaker Corn Bran	19 3/4 oz box
Quaker Oats	18 oz canister
Quaker Quick Barley	12 oz box

Ralstons Cereals

Meusli	22 oz box
Meusli	34 oz box
Meusli with Raisins	22 oz box
Meusli with dried Peaches	23 oz box



Nutritious Corn Cereal With a Crunch Kids Love

- No artificial flavors
- 10 Essential vitamins and minerals
- No tropical oils

Almond Delight	18.5 oz box
Jetsons Cereal	22 oz box
Double Chex	19.5 oz box
Double Chex	29 oz box
Wheat Chex	27 oz box
Rice Chex	23 oz box
Junior Chex	22 oz box
Teenage Mutant Ninja Turtles Cereal	19 oz box
Bran Chex	23 oz box
Corn Chex	21 oz box

General Mills Cereals

Cinnamon Toast Crunch	18.5 oz box
Total	22 oz box
Raisin Nut Bran	25 oz box
Wheaties	28 oz box
Cheerios	31 oz box

Quantity Delete Last Item Scanned Delete Next Item Scanned