

# In The Trenches\_ Conversation with Ryan Farkas

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## SPEAKERS

Steve Divitkos, Ryan Farkas

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**S** Steve Divitkos 00:00  
Ryan, welcome to the show.

**R** Ryan Farkas 00:01  
Thanks for having me, Steve.

**S** Steve Divitkos 00:03  
So the topic du jour today, as you know, is working with intermediaries participating in competitive deals. And we'll go on several tangents related to that as a core. But before we do that, to the extent that folks listening to this are not aware, maybe we could start with you, tell us a bit more about yourself, your background, the arc of your career and what you find yourself doing today.

R

Ryan Farkas 00:32

Yeah, happy to do so Steve. And certainly, you know, thanks for having me on. So, I am exactly as you described, an intermediary, I'm a managing director with BDO, Canada and our M&A practice. Over the last 16 or so years, I've been practicing Private M&A, so would have completed, you know, somewhere in the neighborhood of 150 to 200. Transactions. You know, in terms of the the arc, I mean, pretty straightforward. I was I came out of school and pursued at a CPA designation, and that type of training, pretty quickly got bored a little bit with the traditional kind of audit side of that business. And I would say a little bit of luck led me into M&A. You know, firstly, I'd be lying if I said, I actually knew what corporate finance was when I kind of applied to the role I ended up in and I think the second one, and, you know, looking back in history, it was it took my first M&A role full time it was in August 2008. So, you know, with obviously, what, what transpired in September with Lehman Brothers, and kind of the macroeconomic challenges, I often think if it was a month later, would that role have been there, and would I have gone down the same path in my career? So, you know, love what I do currently sit with, within a practice of about 50 transaction professionals, really advising predominantly on the sell side, you know, it's entrepreneurs, it's private companies, every deal is different, a wide range deal size wise. We're typically looking at things everywhere, from, you know, 10 million to 250 million Canadian and have tons of overlap with, you know, search fund in like, investors, so super relevant kind of investor community for us. And have become an increasing part of the ecosystem, as it certainly as you know, matured in Canada.

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Steve Divitkos 02:23

Yeah, and I know that you have quite a lot of experience working with search funds as buyers from the perspective of a sell side advisor. And that's actually where I want to start. So what I'm hoping to do is to divide our conversation today into effectively two buckets, the first is going to be dealing with buyers, and the second is going to be dealing with sellers, or in this case, coaching your clients. So let's start with the buyer bucket. Where I want to start is, how do buyers stand out? How does any given buyer, whether they're a searcher or not stand out from other buyers? And what, if anything, can they do to stand out from the vast universe of buyers who maybe look and sound a little bit like they do?

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Ryan Farkas 03:04

Yeah, I think ultimately, it's something that I get asked a lot by, by the first time we are introducing ourselves to, you know, a potential buyer and I don't think there's a perfect answer. I do think that, you know, there needs to be an acknowledgment a little bit at the start that buyers and investors to a certain degree, they are a commodity, right. I think that, once you get past that, I think that you trying to force yourself to be different or highlight something that is unique, you know, an advisor or an intermediary that's sitting in the middle has probably heard it before. So I think that I always give the guidance that the role that a buyer can take in terms of standing out is really to make it in intermediaries life easier, I mean, we all have the same goal, which is to close more deals. And so being kind of transparent, and having a concise view as to, you know, what you're looking for, as it relates to investment. And you're trying to map against the style that intermediary, you know, I wouldn't say it's standing out, but what it will do is reduce the friction of that relationship. And ultimately, you know, less friction is going to allow you to see more deals. And as we know in the deal ecosystem, you know, deal flow and quality deal flow and good guidance from intermediaries, is there your best kind of risk adjusted chance to find, you know, the one that you're going to close.

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Steve Divitkos 04:32

So, I'd like to give buyers an enhanced appreciation of the volume that intermediaries face. So at the risk of putting you on the spot as best as you can, what is your your absolute guess, in terms of the number of unique buyers that you have in your database right now?

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Ryan Farkas 04:49

Yeah, I mean, it wouldn't have to be much of a guess. I mean, I would say that we would have, you know, that they're not all live because I think one thing that's interesting about the Lower Mid market It is, you know, the churn that you see, I mean much different than if you move up market and you know, more institutional in nature. You know, we would in our CRM, and this is part of the challenge that we have, you know, we don't yet have a good feel for how many are still active, but we would have 1000 that we interacted with deals over a single last, you know, 36 months. So, you know, it would be, you know, again, it's a robust number, I would say, a better way that, you know, I might give the audience some guidance around this, it would be, you know, it'd be two or three a week, that we would kind of receive an outreach, you know, to myself or something would go around internally, and that would be fairly consistent. So I think always the balances, we would love to get to know everybody, but ultimately, we're trying to do deals. So it's always about finding the right way to interact with that group in the right cadence of communication. And that's why you can sense I lead off with finding a way to do with the least friction possible is the thing that really helps everybody.

**S****Steve Divitkos 06:07**

So, we're talking a database measured in the 1000s, not hundreds, which I think is important context for every buyer listening to this to understand. When it comes to that outreach, Ryan, I wouldn't blame you, if you kind of playfully rolled your eyes every time you got an email from a prospective buyer talking about what makes them different. And ironically, they all tend to have very similar things that tend to make them different. I mean, what type of outreach tends to be most successful or most effective? So to give you a sense, as to what I'm talking about, I had another broker tell me that the most successful outreach is with respect to a specific opportunity. So go on the website, or talk to a colleague and reach out to us about a specific opportunity we have on market, as opposed to just more of like a general type of outreach. Is that a good idea in your experience? Is there something else that a prospective buyer can do to maybe stand out, or at least kind of get your attention more so than the other two to three a week that you're getting?

**R****Ryan Farkas 07:06**

Yeah, I think we, as a practice, really pride ourselves on, you know, we want folks to reach out, we want to try to find a way to integrate them into our deal flow. We use for that reason, we use the unique tool called a deal portal, which quite simply is a private password protected landing page where we post our deals. So that would speak to, you know, Steve, kind of the scenario you outlined around, you know, that we ask people to monitor, we don't want it to replace them reaching out occasionally, but to kind of manage the frequency we asked them to check that as well, because it creates a little bit of two way traffic. I think that we just want people to be efficient in how they reach out and how they manage kind of our time and their time. So certainly, you know, once a month too much, once every two months, I would argue is too much, but it certainly, you know, we entertain both people looking at, reaching out and having kind of broader criteria versus, you know, that super targeted approach, but we want as people to have a, you know, a concise view as to when we're talking about a deal, you know, whether it's a fit, and they want to dig in or not. And so I think they could both be effective, I think on the specific targeted piece. I mean, that really depends on you know, if you need your mediary is kind of making that information available.

**S****Steve Divitkos 08:26**

So you actually touched on my next question, which acts as a perfect segue, which is about acquisition criteria. So tell me from the eyes of an intermediary? What ideally, does acquisition criteria look like? Would you prefer, I'm looking for a B2B services company somewhere in Canada with a reasonably recurring revenue profile? Or would you prefer, I'm looking to buy a sleep clinic in Nebraska? And just give us the push and pull of both of those approaches that a buyer might come to you with?

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Ryan Farkas 08:58

Yeah, there's no perfect answer to that. I think, you know, you're if you're too broad it can get watered down in terms of, you know, staying on an intermediaries radar. If it's too specific, you know, sometimes your initial instinct is, yeah, well, you know, the next time I see a sleep clinic in Nebraska, I will let you know, right? I mean, the proverbial eye roll. Right. So I think that you know, what we certainly encourage is, you know, I would say probably within balance on the broader side. And we ask that people, you know, everybody's heard that term a quick no is you know, the second best to a Yes, right. So I think the commitment from you know, a buyer when we do show them a deal, and that's really to me where it starts. I mean, when you get the ability to talk not anecdotally about transactions, but about a specific opportunity. I mean, that's really where you get a sense for you know, an investor a buyer, what is a fit what is not where do they see, you know, real risk, where do they see opportunity. And so if we can get interacting with with buyers on actual mandates, to me, that's really where it starts. And we can try to assess, but ultimately, the what we asked from them is good information, if they're out, let us know, and if not, give us give us feedback, because that's always helpful as we try to manage our client and kind of move through a process.

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Steve Divitkos 10:25

But I guess there is some sort of tipping point between like, generic enough to be widespread and potentially applicable to a number of different opportunities and industries, versus big being almost too generic as to be almost meaningless. I remember when I first started my search, God bless that first poor guy that I met with, it was in retrospect, is probably terribly embarrassing, maybe more so than I even remember it. But when he asked me the type of business that I was looking for, you know, I said something to the effect of, well, I'm looking for a B2B services company with recurring revenue, high margin, low capex with industry tailwinds or some bullshit and bananas like that. And the poor guy kind of smiled at me and said, I don't know if I have any perfect businesses, but I'll let you know when I do. So, you know, if you were to get an explanation like that, from a searcher, presumably early in their process, and presumably, this is someone who's still kind of wrestling with what type of business they actually do want to buy? I mean, there has to be a point at which it's so generic, that it's almost meaningless to you.

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Ryan Farkas 11:29

So I'm glad you mentioned that, I mean, the unicorn, like we see this, at, you know, we see this often when a searcher comes from, say, an operational background, or are perhaps from upmarket, where I think you have the ability to just see a higher volume of deal flow. So you can start to really, really be refined around, you know, quantitative thresholds, like, no customer more than 20%, right. Like, those types of approaches, can really self select you out of the radar of intermediaries, because, you know, what it tells us is that you don't understand the Lower Mid market. No businesses are perfect, there is no unicorn, the, you know, by definition, the reason a business is at that scale, of course, the opportunities there. And that's why there's such attractive assets, but there are issues with the business, it's going to have customer concentration, supplier concentration, it is a lifestyle business. So, there is no management team that is going to save the day, right? Those are all characteristics that are near and dear to kind of that market segment. And so, one thing I certainly see is, you know, and I think you touched on it early on in the process, until we've had reps, you know, sometimes a new investor or a new searcher that's kind of coming into the market, you know, they've got to wrestle with that. They kind of got to get there, where they're not going to be able to use that type of approach. And they've got to be able to have conversations and kind of come off some of that rigid criteria. So, you know, that's when folks ask, you know, what advice they may have early on in a search, that's often right, where I go, you know, reps are really important and getting a feel for the types of assets you're looking at, you know, really critical to allowing your criteria to evolve through the search.

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Steve Divitkos 13:20

So we've been zooming in on establishing a relationship with an intermediary, establishing investment criteria, let's zoom out a bit in terms of the whole process. So not just establishing relationship but issuing an offer lining up bank financing, running the diligence process, structuring the purchase agreement. From soup to nuts, what do you wish more search funds understood about participating in broker processes or just dealing with brokers more broadly?

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Ryan Farkas 13:53

Yeah, I think one thing I would say is that, I think they need to be more cognizant as to what the intermediary is trying to accomplish, and that there's actually always more alignment than they think. A good intermediary, wants to give you good information, a good intermediary wants you to move through to the next round. So your focus should really be on digesting what information they can give you. Because there's always constraints, there's constraints how you're trying to manage your client, there's constraints as it relates to what other buyers are bringing to the table. So, I think that, you know, zooming out and taking a look at it and saying, if I like the asset, I shouldn't get too ahead of myself. I shouldn't be focused on trying to jam myself into a meeting with the owner right now, what I can control is, you know, what is the intermediary telling me and how do I move to the next phase? You know, at the EOI stage, how do I make sure I get a meeting? At the management presentation stage, you know, ultimately then how do I show my value prop to the owner and kind of pull on my strengths and mitigate any weaknesses I might show. And then again, you small steps will allow you to get to the conclusion, I think sometimes it's driven by excitement around an asset, sometimes. You know, we will get the ask of, you know, hey, can we go meet the owner and do a tour next week, and an intermediary wants to get you there. But ultimately, there's always going to be constraints, you know, around around how you can do that. And that's, you know, you're managing your client, their expectations, and the market and a bunch of buyers all at once, right?

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Steve Divitkos 15:31

Is there anything that comes to mind when I ask like, is there anything that search funds broadly tend to not do particularly well? So I'll give you two examples just based on feedback that I've heard from other intermediaries. One, and potentially you can see the DNA or the blueprint of searchers coming from McKinsey and Goldman shining through one piece of feedback that I've gotten is they ask way too many questions way too early, which is to say that, like they don't necessarily stage their diligence process terribly well, they tend to send over like a 20 page diligence checklist on day one. The other one that I've heard as a point of frustration from certain intermediaries is that they have, you know, two to four LOIs outstanding, simultaneously. Now, we understand why buyers would do that. But it does tend to be a pretty recurring source of frustration among the brokerage community, at least in my experience. So when I ask, is there something that search funds tend to not do particularly well, does anything come to mind?

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Ryan Farkas 16:28

Your first one is certainly bang on and who would have been where I went. Again, I think sometimes a searcher might correctly proceed, you know, give the think that it will be perceived as a level of excitement. And hey, you know, I'm so serious about this, I've spent a bunch of time and have created a bunch of thoughtful questions. But again, as they zoom out and think about the constraints, the intermediary might be dealing with, you know, availability of management to answer those questions, availability of data to feed into the answers of those questions. You know, those are real constraints that as we're moving through a process, you know, we're constantly, not necessarily gatekeeping as a relates to being overly strategic, you're just gatekeeping trying to keep the process moving. And so, you know, by putting in all the expectation that here's the 50 questions, it doesn't actually accomplish maybe what they would envision it's accomplishing, it's actually just putting a little bit of pressure, and it's probably just going on a shelf until later in the process anyway. So I think, demonstrating an ability early on to be super pragmatic about where they are in the process. And again, I go back to that, you know, walk before you run, like, what is the next phase? How do I get to that phase, instead of worrying about confirmatory diligence right now, that is something that, again, with practice, listen, that, you know, searchers come from, often an incredible pedigree, and they will get there. But I think a lot of it is just adapting to that lower mid market. And yet, the only way you'd sometimes do that is to get through a couple processes, get to a few minutes presentations. And that's why sometimes a little bit broader criteria can accelerate how quickly you can get those reps and how quickly you can interact with, you know, intermediaries at the EOI stage and kind of get a feel for the guidance they give you, if you wait until you know, the perfect deal does arrive or as close to perfect as you're gonna get. You might make you might make mistakes, you could have gotten out of the way earlier on.

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Steve Divitkos 18:24

Yeah, I like that. I always encourage the searchers that I work with to to optimize around reps and practice, particularly in those early months. So I guess what I'm hearing from you is that instead of impressing a seller, with the volume of your questions to indicate your level of seriousness, perhaps it's more valuable to impress the seller with the quality of your thinking, and identifying the 10 questions that actually matter and the 40 questions that can potentially wait till later.

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Ryan Farkas 18:51

Yeah, I think that's again, that's a really practical way to look at it.

**S****Steve Divitkos 18:56**

So you mentioned access to the seller a couple of times. And that's where I want to go next. So how do you think about when to facilitate a one on one discussion between your seller and a prospective buyers, because many, many buyers understandably want to get in front of the seller as soon as possible, because that allows them to begin to develop a personal relationship with them. But in some ways, the role of a broker at the risk of oversimplifying is is sort of to shield in a way their clients from having too many of these preliminary conversations. So there's a bit of a balance that needs to be struck. How do you think about when to facilitate that one on one introduction?

**R****Ryan Farkas 19:33**

Yeah, it's something that we spend a lot of time thinking about and ultimately, I do not believe in a one size fits all approach. You know, ultimately, I've always taken the view that to successfully close a transaction, you know, you need to find overlap between buyer market and seller, right. And why it's important to think about it like that in this context is the greater than one market for business. And this is again, the way an intermediary thinks is that the greater the market, the more competitive we feel something is going to be. That's where you sometimes do, you need to create some shielding, you are trying to preserve the ability of the entrepreneur, especially if they're an owner manager to continue to have the business perform. You don't want them distracted early on, you might have a greater variance as a relates to, you know, where offers might land. So, the more buyers that want to submit, you know, the greater variance you're going to have, because you've got more offers. So I think one thing you're certainly factoring into that is, how competitive do we think this is going to be? And are we really, you know, are we adding value by entertaining meetings earlier on? Or do we really use that EOI phase to get down to buyers that, you know, where we see alignment around value and use it as a bit of a gating item. I think, conversely, if you ever apply that rigid approach to deals where the market for that asset might not be as large, you're missing out an opportunity to add value. You can use that, you know, as a an opportunity to, again, bring that buyer closer to that seller. And so I think that, you know, the thing that we're probably most focused on in a situation like that is, you know, where does this deal go broadly, what are the characteristics as it relates to, you know, this business? And if we think we can add value by creating some momentum earlier on with a searcher or any type of buyer, you have to be able to go off script and do that. And I think there's a, you know, there's a feel element to that, as well as obviously, the quantitative facts as to what the business asset that you're working with is.

**S****Steve Divitkos 21:45**

So search funds are, I don't want to say notorious, that's probably the wrong word. But one tool in our toolkit that we tend to utilize pretty often is to appeal to more qualitative considerations that a seller might have in selling her business. So for example, you're treating her employees a certain way, treating her suppliers and customers in a certain way, maintaining the name of the company, maintaining the geographic location of the company, and more broadly, just kind of being a better steward of their legacy. Now, I think that all makes sense. But there's kind of a running joke that like everyone cares about their legacy until the price is too low. So naturally, there's going to be some balancing of both quantitative and qualitative factors. Of course, every seller is going to think about this differently. Because at the end of the day, we're just dealing with human beings. But can you speak to us broadly about how your owner manager clients, think about choosing between buyers? So obviously, I would assume price needs to be good enough, but the highest price doesn't always win? So can you just take us inside the head of the quote unquote, typical seller, even though I know such a seller does not exist? And just help us understand that value proposition that searchers tend to lean on, is that a real thing? Or does that reside entirely within our own heads?

**R****Ryan Farkas 22:58**

Yeah, I don't know, if you're gonna like my answer, right? I think that buyers are, you know, buyers will tend to overvalue the qualitative aspects, and I'm fairly analytical, you know, individual and if I think about all the transactions that I've seen, and then I tried to, you know, quantify the number of times that I've seen a seller actually take a legitimate discount, you know, to lean on qualitative elements, and the numbers not as high as we all might like to think it would be. And so, where I think it does play a role is, no question, in a scenario where there's a marginal difference as it relates to offer, in terms of a top line kind of enterprise value. Or, you know, it's just down to structuring. Again, with a good intermediary, what he's doing is sensing that owners desire that, you know, hey, I really like what I see in that meeting, I really liked the concept of I've got a succession in my business or succession issue in my business. And that I just met, you know, that searcher and, you know, she was fantastic, he was fantastic, I think that they would fit into the culture like that does happen. And, you know, again, again, intermediaries role if he feels that from their client, or they feel that is to try to reverse engineer, you know, that searcher to deal with, it might require a little more structure. Again, I rarely see a seller willing to take a lower top line number, but I think where there's flexibility is structure and the earlier you know, myself in that role can hone in on that, you know, that's where, you know, I'm trying to take deal risk, you know, out of a transaction. So, if I can check the qualitative box, and then reverse engineer the economics to get to where a seller needs to be, you got to lead them to the answer that they want. So I think that's where it really does play a role.

**S****Steve Divitkos 24:55**

Okay, let's move on to the relationship with your clients. So in this case, we're talking about the owners and sellers of these small and medium sized businesses, when you're advising a client and you're negotiating an LOI with a prospective purchaser, do you tend to advocate for detailed LOI so that you can front load those difficult conversations? Or do you tend to advocate for high level LOIs, and defer those difficult conversations because LOIs are non binding in any case, where do you shake out on that spectrum?

**R****Ryan Farkas 25:25**

Yeah, I think very different perspective, EOI versus LOI. So, you know, and we don't always run a two stage process. So I think that would be kind of a unique category. But I think if it's an EOI I mean, you know, ultimately, I have a running joke with my team that I don't think anybody reads EOI's, except for the valuation range, right. I think that so much will change and evolve from EOI to LOI, even let alone, you know, purchase agreement that, you know, I think they really are used predominantly as a gating item for value, and perhaps, you know, one or two other really critical things that might be binary in a seller's mind. So, if that's the case, then that's really all that needs to be there. You know, certainly there might be exceptions to that. But, you know, again, that would be my view on an EOI. As you move to an LOI, I think it's a very different scenario. I mean, again, in my role, what I'm trying to do is to take risk out of a transaction. So, areas where based on experience, or knowledge of that buyer knowledge of that seller, you know, we feel that there's an ability to add detail to an LOI to take risk out of the transaction, because it's settled at that stage. I think that in a perfect world, you would have extreme detail in every area. I think the only kind of thing you're trying to balance is, well, what have what if we haven't been able to deliver enough information to have a real working capital discussion as an example, you know, if we're still kind of working through the roll forward, because we don't have a real finance team at the client, you know, that we the trade off is momentum and time versus something that you're trying to pull forward or pull, you know, to the LOI stage. So I think thematically more detail is certainly, I think, welcomed by both sides. I mean, for a buyer, obviously allows them the ability to get a little greater certainty before they get into expanding a bunch of third party dollars. So, I think, you know, I mean, I tend to get very little resistance around that, I think everybody's got a mutual benefit to try to, you know, within reason iron out what they can at the LOI stage, while being practical. That there's some things that, you know, if a seller and their advisor has not delivered information, it's tough to, you know, ask a buyer to take a position on something.

**S****Steve Divitkos 27:45**

Another recurring source of feedback that I've gotten from intermediaries over the years is that they worry about a searchers ability to close. So my question to you is, how do you diligence any given buyers ability to close? Like, what does that process look like?

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Ryan Farkas 28:03

It depends if I have 10 buyers or one buyer, right. So I think this is where, specifically in Canada, I think the market is matured a lot. And obviously, availability of capital, you know, plays a role here, you know, we feel a lot more comfortable now than if I went back to the start of my career, how my MD might have felt about a search fund and their ability to deliver equity. I think that where I sit on this is, you know, I'm a big believer in, you know, what have they demonstrated behaviorally through the process to this point, that gives me comfort that they can get there? So if they've got a ton of deal experience, you know, obviously, that's a huge plus, if they don't, as an example, you know, have they put people around them, whether that's advisor, whether that's they're working with a Steve as an example. Again, do they have, you know, an ecosystem around them on the investor side, or just the adviser side that would allow them to bridge the gap, if they come from, say, a purely operational background. Because, you know, moving through the confirmatory stage of a deal is unique to, you know, the confirmatory stage of a deal. So, we want to have confidence there, you know, we certainly do want to learn what we can about who their investors are, how broad is that group? How much do we think they're stretching? You know, what is their track record, as I mentioned, you know, and I think the other piece of behavior that we really like to see, as they have demonstrated an ability to be pragmatic, no deal moves in a straight line. A lower mid market deal, when I find one before the end of my career that doesn't encounter it an issue and diligence, you know, I will be very excited and won't believe it's actually happened. So, you know, it's par for the course and we need to have confidence that we will do the best to manage our client, but we have to have confidence in a buyer that, you know, the reaction is going to be one of, we've hit a problem, how do we solve it. As opposed to, you know, we've had a problem, purchase price adjustment, right? I mean, I think and that's always what you're guarding against is you try to manage your client and kind of navigate towards close.

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Steve Divitkos 30:10

At the early stages of working with a client, I'm so curious to learn more about how you coach them on valuation expectations, because in my experience working with sellers, I mean, look, nobody's got the ugly baby, right, everyone's company is more unique than perhaps they actually are. I would suspect that the propensity of the average seller is to overvalue our business, as opposed to undervalue it, but you correct me if I'm wrong, sometimes, in my experience, sellers had numbers in their head that were completely dislocated from the economic realities of their company. So for example, they would say, you know, I think my company is worth 10 million. Why? Well, because 10 Millions, you know, the number that I need to retire comfortably, regardless of how profitable or how growth oriented their company is, given that kind of messy landscape of expectations. And these are not capital markets, experts, these are experts in building, you know, the, the businesses that they built, walk us through that process of how you coach clients on valuation expectations.

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Ryan Farkas 31:12

You know, Steve, I have to say, it is amazing how many sellers just believe their business is worth 10, 50 and 100 million? Those seem to be really popular numbers, right?

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Steve Divitkos 31:24

Of course.

R

Ryan Farkas 31:24

No, you're exactly right. You know, sellers are emotional, there is a legacy, you know, oftentimes on many of the mandates we're working on, it has been in the family for 10, 20 or 75 years. So that certainly that has a propensity to lead to, you know, perspectives that might not be routed in what market is. I think that, you know, our role, and we don't do this solely to try to get to the right answer, we do this also to manage risk on our own end, you know, we're going to expend a lot of time on a mandate through a period of whether it's eight months or 12 months through, you know, through to closing, and we take a lot of risk. So I believe that, you know, it's imperative on us is we manage what we're taking on to get alignment with the seller. So, and it's one thing, I think, as the market moves through cycles, you know, we've lost a bunch of mandates over the last, you know, eight months, 12 months, not because we perhaps weren't, you know, right at the top as it relates to who they would, you know, economic socide, who they would select as an advisor, but because we're just not being as aggressive because we felt like the market had perhaps peaked and pulled back a little bit. And we started to have, you know, a bitter a larger bid ask as it relates to what we a seller was communicating they wanted, and what we felt the business was worth. And if other advisors are thinking about it more just to win the mandate, you know, that's where you start to see sellers come back and say, well, someone else says it's worth X. So I think, as an intermediary, what you want to do is provide your client or your potential client with the best information possible at all times. And that has to be routed in your ability to get a transaction closed. And so we start that from the first meeting. And ultimately, I think that if you develop a track record of closing deals, and enough of a funnel as it relates to, you know, keeping yourself busy and your practice busy, that always works that approach. So ultimately, a seller who's going to take the biggest number, they have a certain dynamic around them, they might get something closed, they might not. But the way that we manage that right from the start is philosophically presenting them with what we think is an achievable deal, as opposed to something that we know we're going to struggle to achieve. And are we right all the time? No, but you gotta make your best guess.

S

Steve Divitkos 33:56

So that's on the value side. What about the structure side? How do you coach them on structural expectations? And I guess a related question is, does it tend to come as a surprise to most sellers, that transactions are typically not paid 100% upfront in cash?

R

Ryan Farkas 34:11

It probably is to some at the outset. But again, I think this is an area that is almost more important than valuation, especially in the Lower Mid market. I'm not gonna say it never happens, but outside of a strategic, you know, in very specific circumstances, the majority of deals do have some form of deferred consideration. So, ultimately getting a client comfortable with that early on is, you know, is absolutely critical to managing their expectations. And again, creating that convergence between market seller and buyer. So, I think that we have that in our initial kickoff documents with a client, you know, all the time. It's an emphasis of discussion, and not just the fact that there will be deferred consideration but starting to get a feel for amongst the various types, you know, what resonates with that seller? And so I think that's, you know, it's imperative on us to do that again to try to ensure that when it comes time to negotiate said transaction with prospective buyers, you know, we've created some alignment that we're not surprising our seller, as you say, with, again, an element of well, where's the 100% cash offer?

S

Steve Divitkos 35:26

Yeah. So there are a lot of tools, as you know better than most to align interest between buyer and seller, and to keep some quote unquote, skin in the game for the seller. Among the menu of options, seller notes, contingent seller notes, equity roles, earnouts, these are all kind of on the menu of aligning interests in buyer and seller, how do you coach your clients on the merits and risks of each of these? Like, is there one that tends to be more preferable than others? In certain situations, do sellers tend to gravitate more towards seller notes, let's say because they're more senior in the capital structure? How do you coach them on the merits and risks of all of these different tools?

R

Ryan Farkas 36:07

Yeah, I think that's a really good question. These types of tools are, they're all risk sharing components, right. So, ultimately, what we're trying to do early on in a transaction, and this is well, before iOS or otherwise are kind of into into confirmatory diligence. I think it's important to establish the risk tolerance of your client. And so naturally, a client with a higher degree of risk tolerance, that's the client that, you know, might gravitate more towards my business will perform, I'm willing to take some risk, and an earn out might be the right solution. The type of owner that, you know, is sitting there, when you start working with them with a bunch of redundant cash on the balance sheet, because they would never take on \$1 a debt, and earn out is probably not going to appeal to that type of risk tolerance. So I think it's, you know, it's about knowing your client, it's about trying to get a feel for them early on at the EOI stage, even if you're not negotiating the details on the structure, then starting to get a feel for where they would have flexibility, presenting it to them as a menu, you know, hit the we know that we're going to have to feed the opportunity to buyers to have some deferred consideration, you know, what works for you. And if you can approach it like that, and again, you know, you can take that information, and do a little bit of guidance, providing and coaching to the prospective buyers to try to, you know, ensure that they can live with what would work for a seller. So, I think it really comes down to risk sharing. It comes down to, you know, how much risk sharing do we need to do to bridge the bid ask, you know, the greater the bridge, you know, the more you need to share risk, which might lead you more towards an earn out. I think that on most of the deals we do, I think that, you know, a vendor note is probably the simpler solution. I think, an earnouts, while you can use them as a last resort, you know, as we all know, there's a degree of complexity that can make them challenging, but in part because it's tough to get alignment, you can end up with, you know, earnouts that at least have the optics of misalignment, which can be challenging to try to manage through the legals, right.

S

Steve Divitkos 38:18

Yeah, lots of unintended consequences in earnest, or at least the potential for lots of unintended consequences.

R

Ryan Farkas 38:23

It's about the optics, it's not always about the intention of the parties. Right. And sometimes, you know, that's just as powerful, right?

S

Steve Divitkos 38:29

Yeah, I've heard certain lawyers in our ecosystem referred to EBITDA based earnouts as deferred lawsuits. Just because it's, you know, EBITDA simply agreeing on what EBITDA is, as simple as that may sound is often much more complicated than one might initially think.

R

Ryan Farkas 38:50

No, and which is certainly what I've done, or, you know, what we attempt to do is, if we're going to introduce an earn out, or we're going to propose it, I mean, trying to push it further up, the income statement is again, you know, and it's not where you want to, obviously, again, an earn out is not necessarily the go to solution. But if it is, I think pushing it up, you know, whether it's a gross margin based turnout, or whether it's revenue or whether it's a binary act around, you know, the retention of a customer. I mean, I think there are ways that you can, again, try to just increase the element of alignment, you can get your client comfortable on the sales side that hey, a buyer is going to want to do this because there's a consequence if they don't, that's greater than what they would owe you, right? I mean, that's what it all comes down to.

S

Steve Divitkos 39:37

Let's talk about deals falling apart. So anecdotally, my experience is that and I'd be curious to hear if you have a comparable number elderlies have a quote unquote, success rate of somewhere between like 25 to 33%, which is to say, you know, two thirds to three quarters of LOIs generally don't close. So, I'd like to get your reaction to that. But before we get there what in your experience are the three most common reasons why deals fall apart in the late stages, and if there is something that a prospective buyer can do to kind of mitigate or get ahead of some of these risks, I'd love to hear that as well.

R

Ryan Farkas 40:17

In this, we are well armed to talk about this one, you know, in our practice, we, you know, we've closed about 100, sales side transactions in the last three years. And we just went through an exercise of looking at that population and trying to draw out some trends, some things that we saw repeatedly. And certainly now, I would say that, you know, these numbers are probably elevated, because we're looking at 21, 22, and 23. So I think a good chunk of that is through a period that might have had some elevated closing rates. But in terms of through that time period, you know, we were at about a 70% close rate on an LOI being signed. So that, you know, is kind of a reaction to the first number that you provided, I would expect that longer term, that's not sustainable. Like, I think it might be a little lower, but, but certainly, I think higher than 25, or 30, would be your would be my hope, and I and my, my instinct, the in terms of the deals falling apart. I mean, I think that one, one jumps to mind, and that would be the, you know, and this would be pretty specific. But again, back to the conversation we had a couple of minutes ago around the deferred consideration, and how that is managed is, we've had several deals fall apart around the subordination of a vendor note and how just security is dealt with. And certainly, you know, what we draw out of that, and I think it's become an increased emphasis for us is ensuring that we've got quality, legal counsel on our side, as part of the team with our client. Because nothing can introduce risk, you know, late in a transaction, when we're already, you know, 6, 7, 8 months into investing in a deal is legal counsel that, you know, just doesn't have the prerequisite experience from a deal perspective, to be able to know, what's market and how to handle complexity as it relates to the structure like that. So, it's not a massive number. But if we went through that population, we had more than a couple of deals that again, had very similar kind of outcomes driven by similar pain points. And that was all around a seller's willingness to give what, fundamentally a buyer couldn't control, which is what their bank needed. Right. So I think that was, that's number one. And again, I think the the lesson to everybody out there, and how you can manage that risk, and I think as it relates to a searcher would be, you know, not just as the seller getting good advice from a, you know, a broker perspective, but at the LOI stage, like, who is their counsel, right? And pulling through, like you mentioned, you know, what items, do you want to ensure crystal clear in an LOI? You know, that that's one that, given some of the experiences we've had, we absolutely ensure is dealt with, you know, at that stage, without any exception.

S

Steve Divitkos 43:32

Yeah, that makes sense. I mean, if something has the potential to blow up a deal a month from closing, you might as well front loaded into the LOI conversation and get that, you know, defuse that time bomb as early as you possibly can.

R

Ryan Farkas 43:43

Yeah, so I think that that's one, I think, another one and this would be, you know, I think, in line with just the macro trending that we've seen is real estate can sometimes present an issue, right. Again, maybe not, you know, always killing a transaction, if you will, but just, you know, a pain point can be sometimes, you know, and this is regardless of whether a piece of real estate is in a transaction or out, it's just if the, you know, if the fair market, rent has not been dealt with appropriately. If there's an appraisal that moves around, and again, this is partly a function of just the appreciation of real estate in some of the core markets in which we operate. So that's an area that we've seen. And then I think, you know, business performance, I think, certainly as we come, you know, further out of COVID and the call say the kind of, you know, the outperforming that many businesses saw with the liquidity that was in the market more generally, you know, we've certainly started to see in the last 12 months, some underperformance. We've seen businesses misforecast, and and that that brings, I think it's a balanced market, but that brings, I think, risk into deals that you know, always has the potential if not managed appropriately to create discussions and sometimes discussions create friction, which can have an impact on a deal closing.

S

Steve Divitkos 45:07

So glad you mentioned business performance, because that is something that I wanted to ask you about. So excuse me, in my experience, in 2018, I tried to sell my company unsuccessfully, it didn't work. But in one of the things that I learned, or I guess, started to appreciate at a more visceral level, was just how darn hard it was to run a sell side process alongside a broker, while simultaneously still fulfilling my full time job as the CEO of business. I mean, intellectually, I knew it was going to be hard. But I came to appreciate just how hard it was. And partly as a result of that the performance of our business suffered. And indeed, that was in fact, the primary reason what the deal ultimately fell apart in its late stages, what I wanted to talk to you about is the art and science of forecasting as a seller. I mean, in my experience, the overwhelming majority of these businesses don't do forecasts. So when they're selling their company, they're basically creating a forecast. In many cases, for the first time. I found it to be a bit of a delicate dance, because on one hand, you want your forecast to be optimistic enough to paint a rosy picture for the buyer. At the same time, you can't make them too optimistic, because if you do, you introduce the risk of underperformance relative to those awfully rosy forecasts. How do you coach your clients on the art and science of forecasting in a deal context?

R

Ryan Farkas 46:34

Yeah, and I mean, you hit the nail on the head. I mean, I think that I would say that half the time, you know, at minimum, the forecast is being created, because there's a deal going on, and we're trying to provide some guidance to our prospective buyer population around the forward looking prospects of the business. So whenever you're introducing an entirely new process, you know, to a management team, they don't know how to approach it, they're looking to you as the intermediary to provide some guidance. I think that you try to find the balance around being conservative, but also making sure that you're communicating quite clearly to your client, that if you're too conservative, you might be leaving value on the table. If you feel like you look at a number and the business is going to outperform that. But after the fact, you might be leaving some value on the table, because you can push buyers to purchase, you know, ascribe some value to some of the growth that you're seeing concurrent with the process. So I think there is no perfect answer, we've had some cases where we just haven't put a forecast, I do believe that, depending on the management team and the ownership group, you're going to meet the owners. You're going to sit across the table for them, before you sign an LOI, and before you close the transaction as a buyer. And so, it's going to become abundantly clear, when you go through that process that this management team doesn't even have an accountant, like nobody prepared a forecast. I believe transparency sometimes is takes risk out of a transaction again. So there's been times where we've decided to not put a forecast and to be pretty transparent with buyers to say, it's not part of their process, all we can tell you is, they feel like next year will be the same or better than last year. And that might sound like a terrible answer. But I feel what it does do is communicate quite concisely to that buyer that this is what the organization is. We're not going to oversell what you're getting as it relates to the sophistication of the client and their ability to give you better answers and confirmatory diligence. Like it allows you to almost pull forward that discussion, which again, not always the right answer, but you got to understand the client and what they're capable of and ultimately, where a buyer is going to land when they're sitting across the table from you.

S

Steve Divitkos 49:03

Yeah, yeah, again, a very, very delicate balance in my experience. If I were to ask you a bit of a hypothetical question, if I were to survey, let's say, 200 of your previous clients who have successfully exited, and I asked them, what were the most unexpected or surprising things about selling your company? What answers do you think I would hear most frequently from them?

R

Ryan Farkas 49:27

How complicated it gets, how complicated it gets and how complicated it gets? Is that I think, No, I think that, you know, ultimately that it takes a long time. There's a lot of questions and I'm not necessarily sure where that comes from. I think sometimes you say to a client, you know, how do you expect someone to cut a check for \$25 million to you and not ask questions? Like I think it becomes a A process that they're uncomfortable in many times again, you know, as we've talked about, I mean, they're operational at the core, a lot of times they run their business, they don't do transactions. So I think they often end up most surprised that just the depth that buyers will go to, and certainly technology is facilitated this. I think the ability to have virtual data rooms, the ability to have advisors that are helping a buyer that can be stationed anywhere, I think that has, you know, added to the depth of the work that gets done. But I think they're continually surprised at just how long it takes, the complexity and the specialization that it requires to successfully get it done. And more than not, I think, at the end of it a greater appreciation for maybe some annoyance. I think there's definitely part of that, but appreciation for just the specialized skill set that it takes to navigate through a transaction on all sides with all stakeholders that they encounter.

S

Steve Divitkos 51:01

That makes total sense to me, and is entirely consistent with my experience. What about working capital, that also tends to come up pretty frequently as something that sellers? Are you surprised by, don't particularly understand? Where might that figure into the answers of these 200 randomly selected clients?

R

Ryan Farkas 51:21

Yeah, you know, I think it's probably an item that of those 200, you know, only 10 really understand, right? I mean, I think first for an item that, you know, you've been around transactions long enough, you say, you know, in two subsequent sentences, you'd say, well, working capital is a very simple concept, and should never lead to any disagreement, it is what it is. And then your next sentence will be, it also creates the most tension in the deal, you know, than anything, right? I think it's, you know, again, especially in the Lower Mid market, and I'll draw on an example, right now. We're working on a transaction, right now, it's a nice sized asset, it's about a \$50 million deal. The company doesn't do monthly balance sheets, they don't have a perpetual inventory system. So, you know, to negotiate working capital involved, you know, one, us trying to articulate very early on that there would be an adjustment to try to figure out how we would use some assumptions and approximate what a monthly balance sheet as it relates to the inventory balances would be. You know, three, get a client comfortable with that concept, once we created some of those assumptions. And now we're in the process of trying to work with our buyer to get them comfortable with it. So it's in a lot of family, cash rich businesses that might have been historically debt averse, they're over capitalized from a working capital perspective. So you are trying to find the balance of trying to help them monetize maybe some of that, but still trying to tell a story that will clear with the buyer, right. So I think, you know, it's a simple concept, working capital, but one that certainly, you know, sellers really do struggle to understand and to kind of comfortable with the mere fact that they're gonna have to leave a bunch in the business. And they, you know, might have a negative adjustment, even though it's not really a negative adjustment, because they took all the cash out that was in place without working capital. So it's, you know, by the end of my career, maybe I'll figure out how to explain it appropriately.

S

Steve Divitkos 53:27

You and me both. Let's move on to this, concluding, in some cases, more personal questions. What is the most important part of what you do that is least well understood by those on the outside looking in?

R

Ryan Farkas 53:44

Yeah, I mean, I think this question for me, and this is something I've gotten more comfortable with managing, but I think it's just the stress and the pressure of deals. I think that, you know, you don't want to be too dramatic about this stuff, but lower mid market businesses, and the processes, they don't involve professionally run companies all the time. I mean, everyone is kind of talks about these processes, and they're more psychological in nature than they are, you know, finance and economics. And that's the truth. I mean, the reality is, is the deals that you're working on are often the most important transaction that that family or that owner is ever going to do, or at least to that stage in their life is perhaps participating in. And so I think sometimes as you get older, you know, it takes a fair amount of energy to, to not get hung up on failure when you're working on a transaction because you have to find a way to compartmentalize it. Otherwise the toll will bear upon you, but while still having empathy for the fact that you know, for your clients, this is their generational wealth. This is their retirement. You know, we all know how kind of cash poor sometimes business owners are. Because, you know, they've continually invested in either the balance sheet or just the fair market value bump that sits within the equity of their business. So, to me, that's something that we talk about it, but that's just real. And it's what makes it fun. But that's I think something that we sometimes lose sight of.

S

Steve Divitkos 55:21

So before we hit record, you and I were both talking about our mutual sense of imposter syndrome. I mean, you know, who doesn't have that, but it's a perfect segue into my next question, which is, in what areas of your professional life do you still feel less sure of yourself?

R

Ryan Farkas 55:37

Yeah, you're shorter list if you say in what areas are you very sure of yourself? No, you know, I'm in my early 40s, I still feel like a young associate. And I think sometimes, you mentioned impostor syndrome, but, you know, you go into a pitch, knowing the right adviser for someone, but reflecting and looking at who you're sitting across the table with, and it's an entrepreneur who's built a phenomenal business that is worthy of a large sum of money. And I think, you know, or you're going into a negotiation with, you know, a private equity veteran that has a track record that again, you you could only dream up, right. So I think those are areas where until you succeed in those types of environments, it's not till after and you have some reflection that you maybe know you're talking about, but actually the going into them and during them, I think you're always, you know, unsure of your ability to perform.

S

Steve Divitkos 56:44

Yeah, yeah. And what's particularly interesting about that observation is, even when you do succeed, you'll still be unsure of yourself, you'll just be unsure of a different part of it.

**R** Ryan Farkas 56:51  
You got lucky, there you go.

**S** Steve Divitkos 56:54  
And finally, what is the most meaningful lesson that you've learned over the past 12 months, and this can be anything, it could be business, it could be professional, it could be personal, spiritual, emotional, anything?

**R** Ryan Farkas 57:08  
It's funny, because, of course, you feed us these questions. And if I had to, you know, I probably allocated 20 minutes to look at all the others and thought about this one for like, 20 minutes. Right.

**S** Steve Divitkos 57:19  
Good.

**R** Ryan Farkas 57:20  
So I'm not going to suggest that I've learned it by any means. But I would say, and this would be, you know, incorporate kind of both personal and professional and how they overlap. But I think I've got a two year old son, my wife is pregnant with twins. And we're expecting in like, the next week or so. So yeah, I've spent the last six months just thinking about, now that I'm at a fairly mature kind of arc, or as it relates to the arc of kind of what I do currently, like, how it needs to evolve. And I love transactions, I love advising owners, and certainly have every expectation I'd like to do this for for quite some time, but trying to find a way to do it, that finds the Everlasting search for balance between professional and personal is a lesson that I hope to learn. So maybe it's not something I've learned, but it's something that I think is becoming huge focus to try to figure out, at least where I want to try first.

**S** Steve Divitkos 58:24  
Yeah, yeah. super interesting. Ryan, it's been a total treat to talk to you today. Thank you so much for joining us. And thank you for being generous with both your time and your insights.



Ryan Farkas 58:38

Steve, listen, it's been great. You know, could talk for hours and hours about kind of what we do and the ecosystem that surrounds it, but you know, really appreciate you having me on and fantastic to talk about some of the stuff that we that we do all day every day.