



Using TOC to Make Real Money

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Theory of Constraints Practitioners Alliance

www.tocpractice.com

About this webinar

This webinar is all about how **YOU** and your friends (who will undoubtedly be necessary) **make lots of money**, using your TOC knowledge





What's wrong?

We PUSHED!



We know that **TOC** relies on *PULL*, yet we **PUSHED**:

- We PUSHED consulting, when TOC was unknown
- Advocates PUSHED TOC on their management and employees

Why? Eli's personality – Time pressure – Intuition

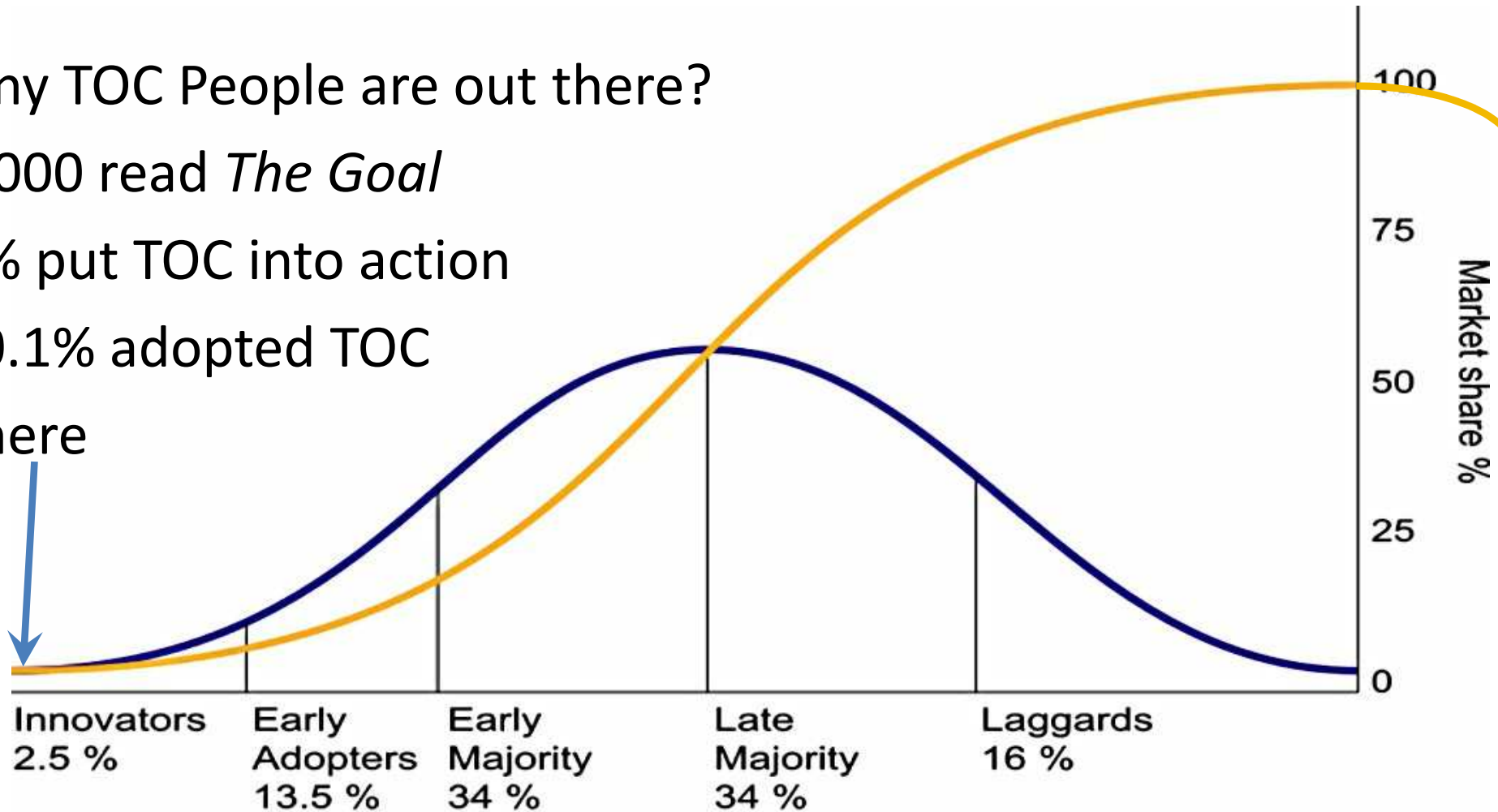


S-curves

How many TOC People are out there?

- 7,000,000 read *The Goal*
- If 100% put TOC into action
- Then 0.1% adopted TOC

We are here





S-curves

% implement *The Goal*

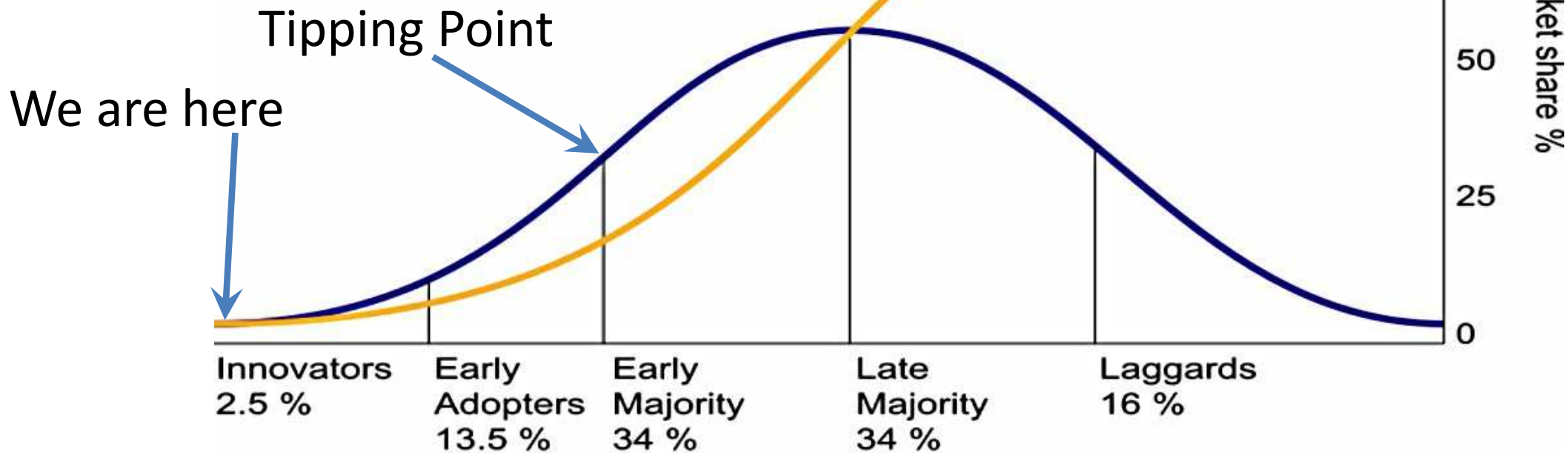
100%

10%

Increase to tip

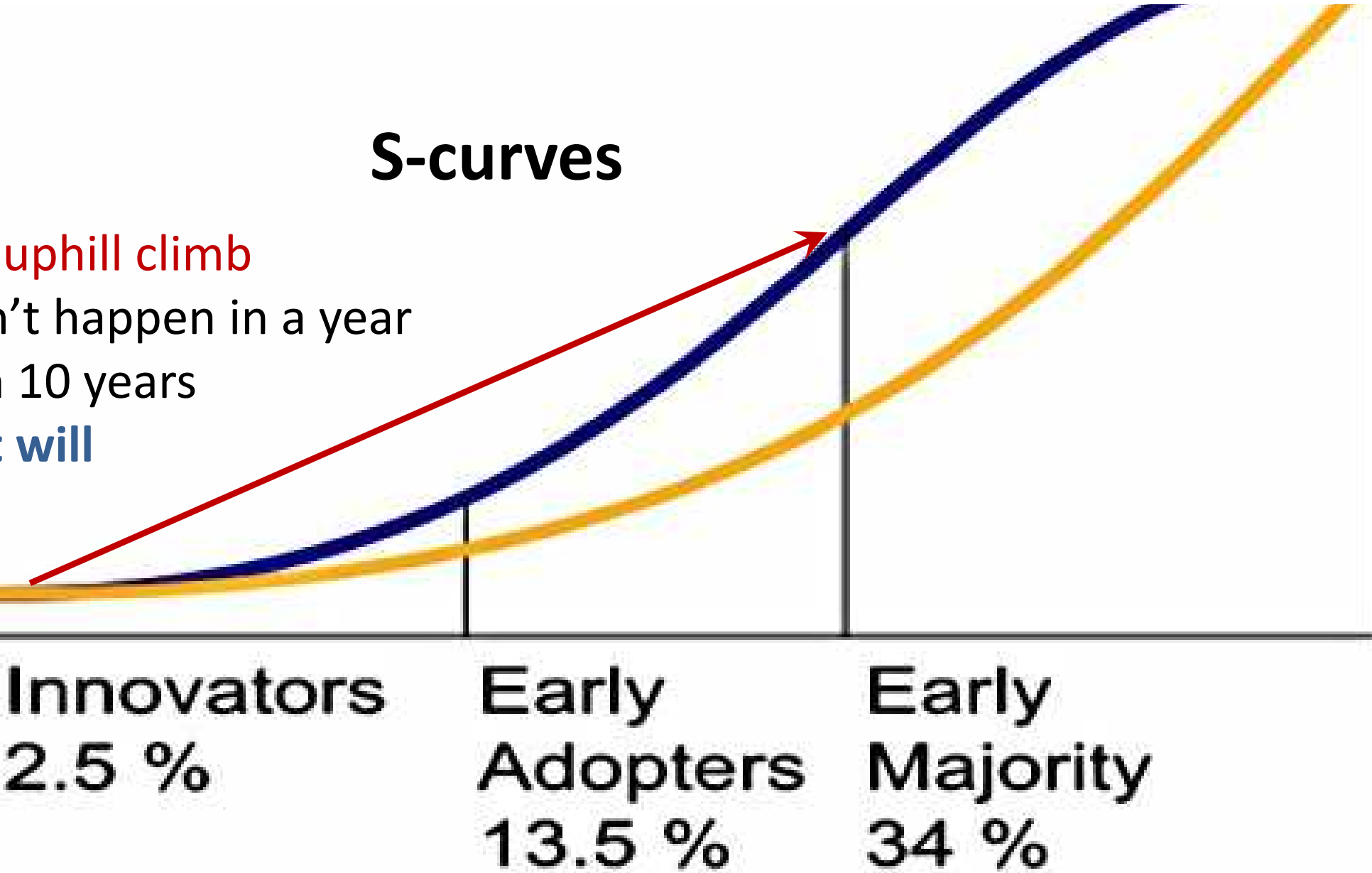
+150X

+1,500X



S-curves

Its an uphill climb
It won't happen in a year
Not in 10 years
but, **it will**





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How to earn impossible to ignore wealth?

Acquire a company,
even if you already own one

It takes ~~money~~ to make
money

Here are 5 easy steps



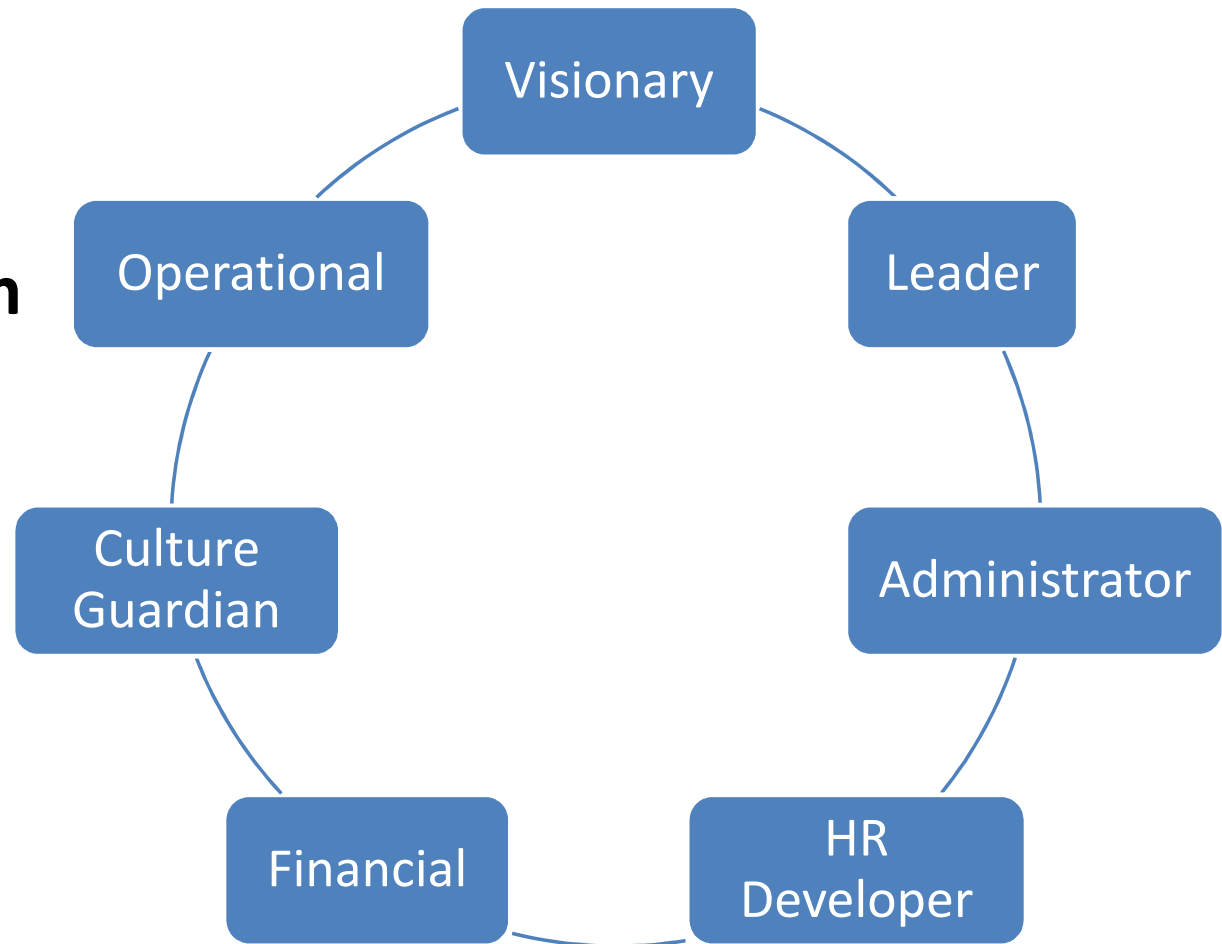


How to earn impossible to ignore wealth?

Step 1:

Build a **multifunctional team** that covers the bases

Choose a company big enough that not too many positions must be shared





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Step 2:

Find a company

But where?

- Business ~~brokers~~ – waste of time!
- Direct approach – research
 - Obvious benefits from TOC
 - Not in trouble
 - Unless you already have your own stable platform





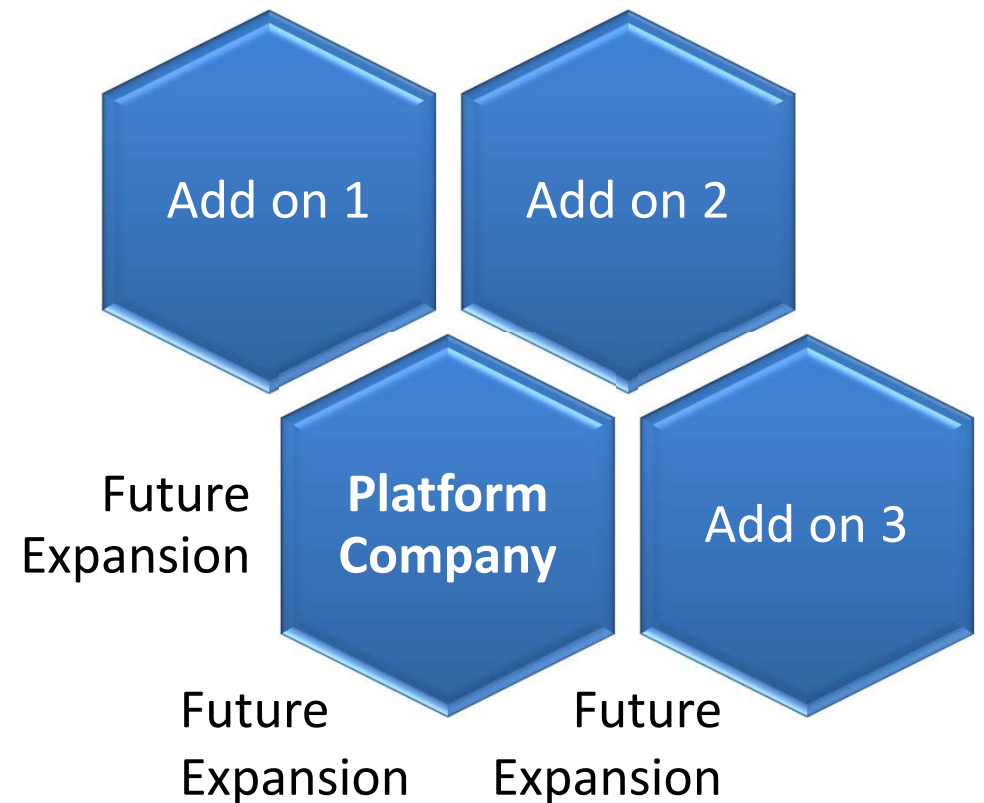
How to earn impossible to ignore wealth?

Step 2:

Find a platform company

The platform is most important

- Where your team wants to be
- Team members can come from the acquired company
- TOC upside vision is clear to you





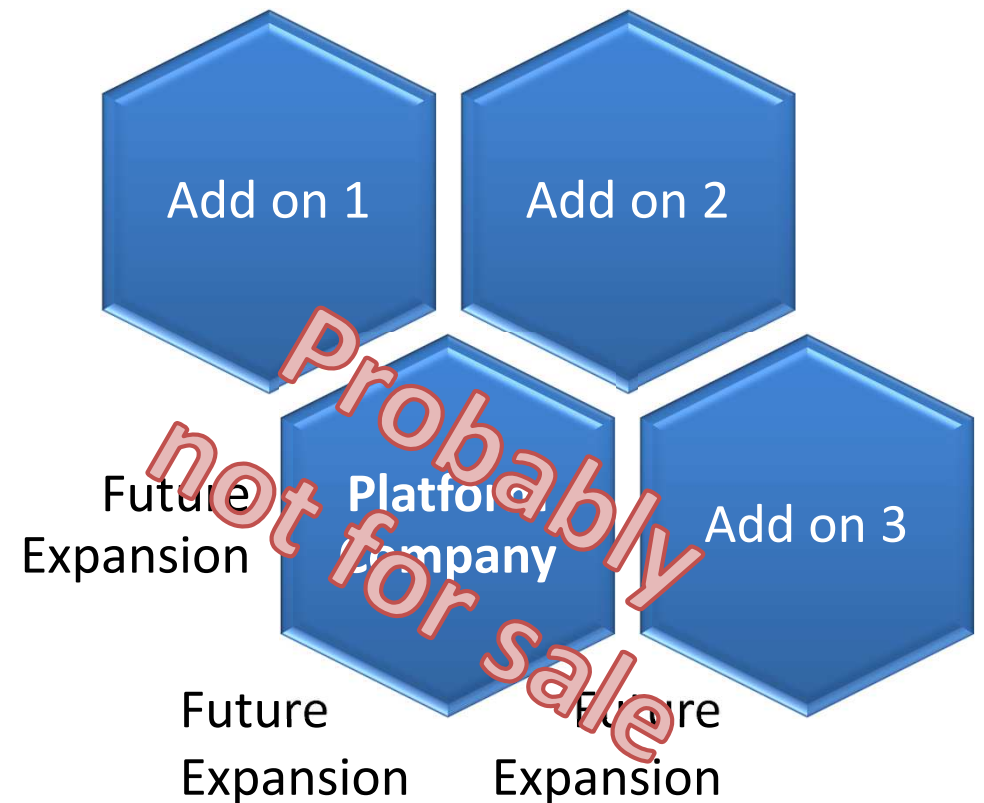
How to earn impossible to ignore wealth?

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How to earn impossible to ignore wealth?

Step 3:

Research the owner(s)

Take your time

- LinkedIn
- Common friends
- Customers
- Use a private detective





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Step 3:

Research the owner(s)

Get an introduction

- Warm – personal
- Identify his/her pain





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Step 3:

Research the owner(s)

Build rapport

- Differentiate your claim
- Make it tangible





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Step 3:

Research the owner(s)

Ask for motivation

- Find a win-win
 - This will involve **paying too much!**
- Interested?





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Step 4:

Strike the deal

Sign Mutual non-disclosure agreement

- Get historical financials
- Ask for **their** price
- Negotiate in narrow range around that price





How to earn impossible to ignore wealth?

Step 4:

Strike the deal

Are they **in or out**?

- **In:** Explain TOC advantages
- **Out:** Give conventional explanation for offer





How to earn impossible to ignore wealth?

Step 5 has **three parts** (a, b and c) that all **happen simultaneously**

It pays to **prepare** all three parts **in advance**

- Details can be added later once they are known to avoid this and this





How to earn impossible to ignore wealth?

Step 5a:

Provide Letter of Intent

... which triggers:

- Quick due diligence period to verify claims and look for undisclosed problems
- Adjustment of price, if indicated





How to earn impossible to ignore wealth?

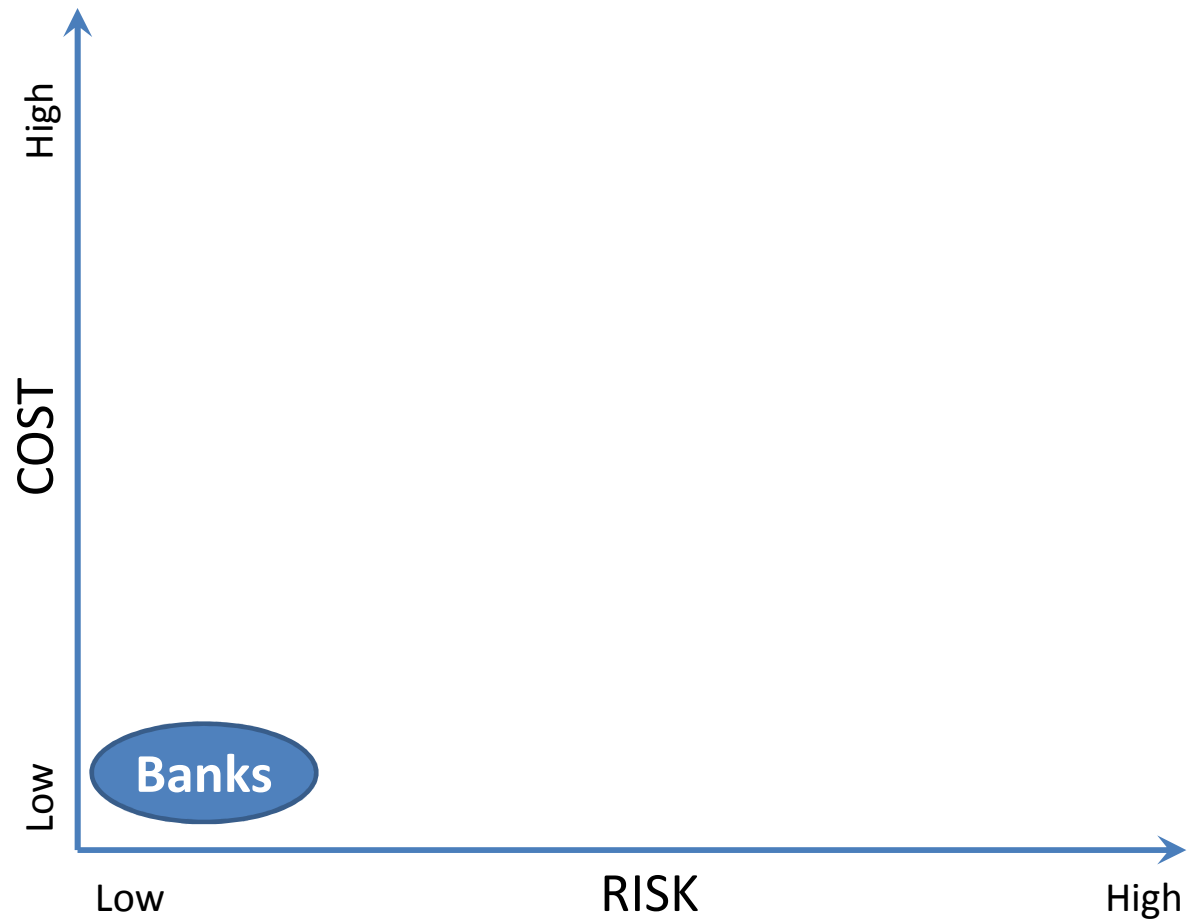
Step 5b:

Arrange Financing

Sources:

Banks require:

- 3 yrs Solid Earnings
- Cash flow coverage 2:1
- Climbing retained earnings
- Total leverage < 2:1





How to earn impossible to ignore wealth?

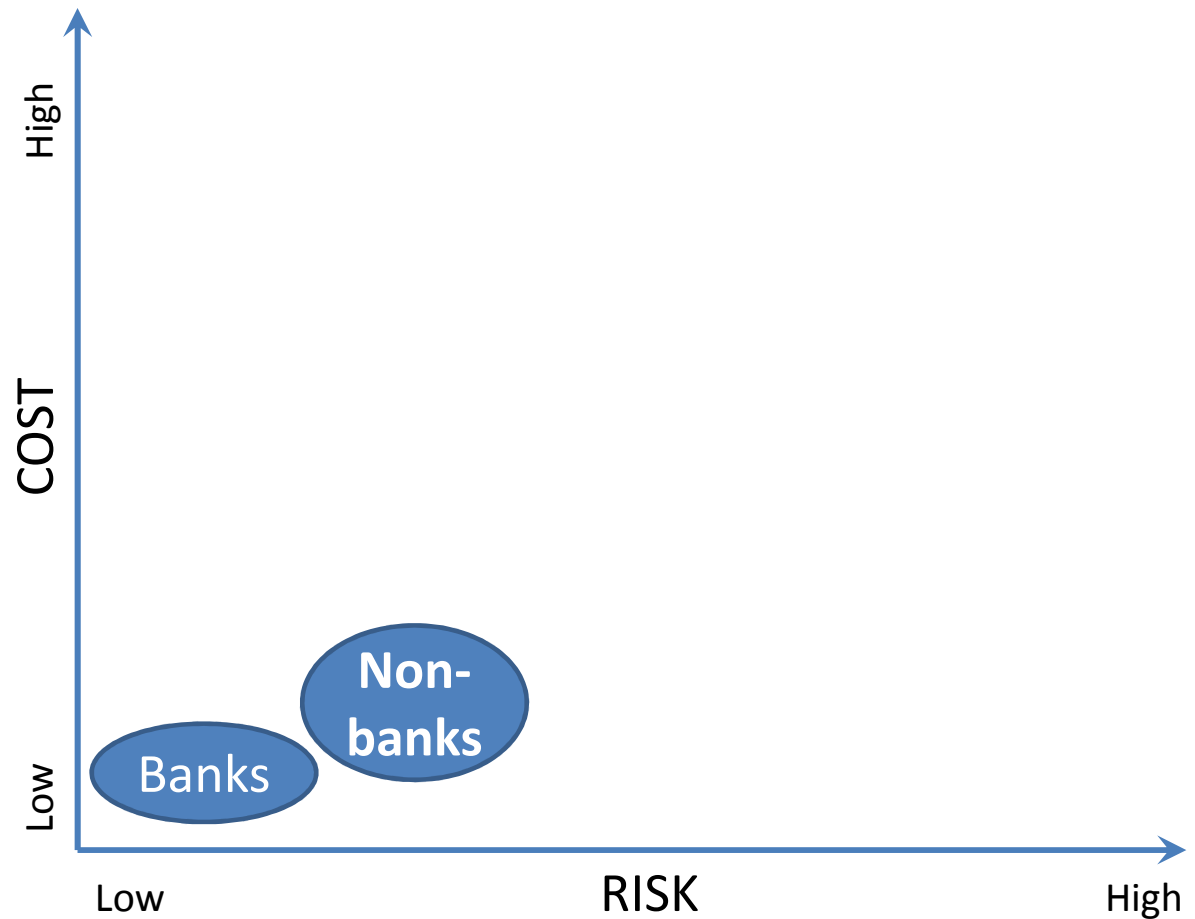
Step 5b:

Arrange Financing

Sources:

Non-regulated lenders

- Insurance companies, Pension funds, etc.
- Lend based on expected future cash flows
- Bank rates +2 to 3%





How to earn impossible to ignore wealth?

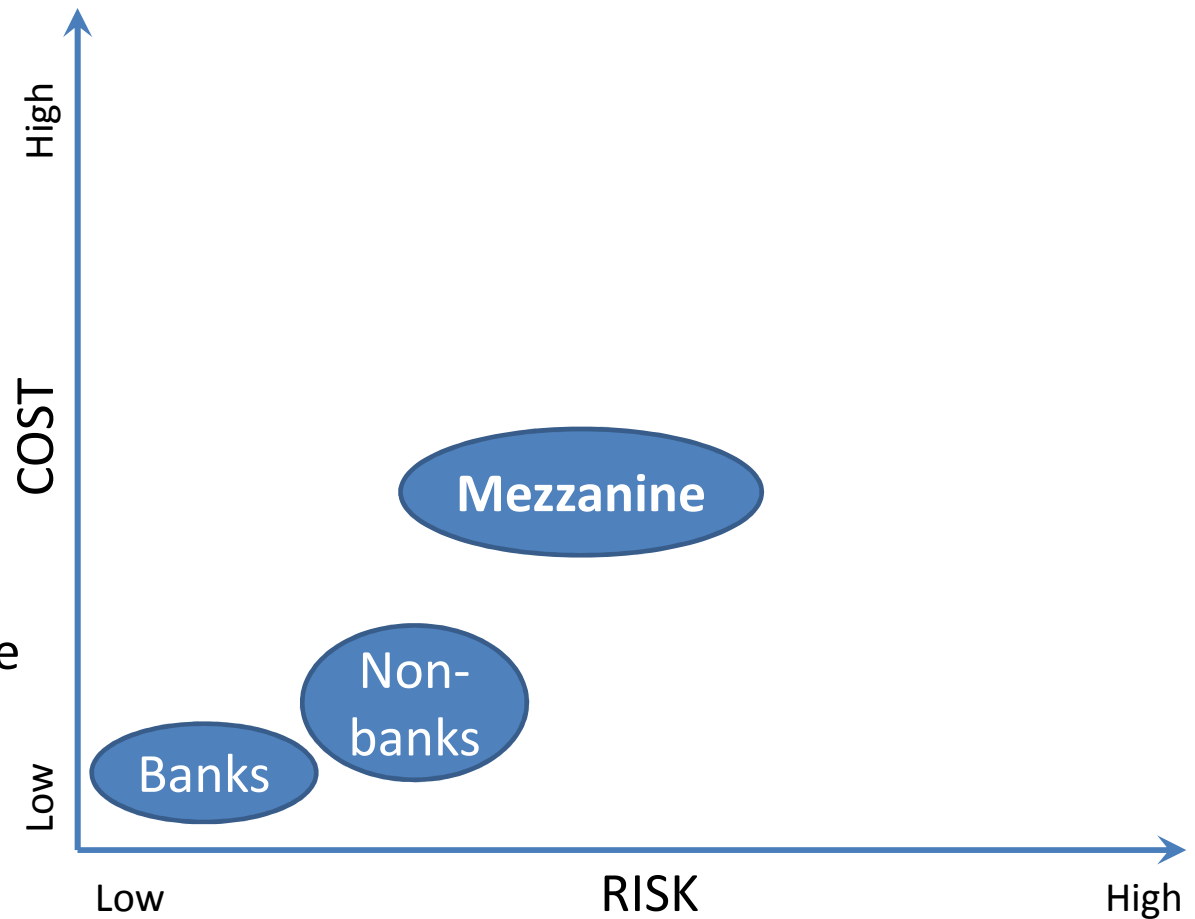
Step 5b:

Arrange Financing

Sources:

Mezzanine lenders

- Lend based on future cash flows
- Unsecured, **no** personal guarantee
- Flexible principal repayments
- Bank rates +5% to 10%, depends on security, fees & warrants





How to earn impossible to ignore wealth?

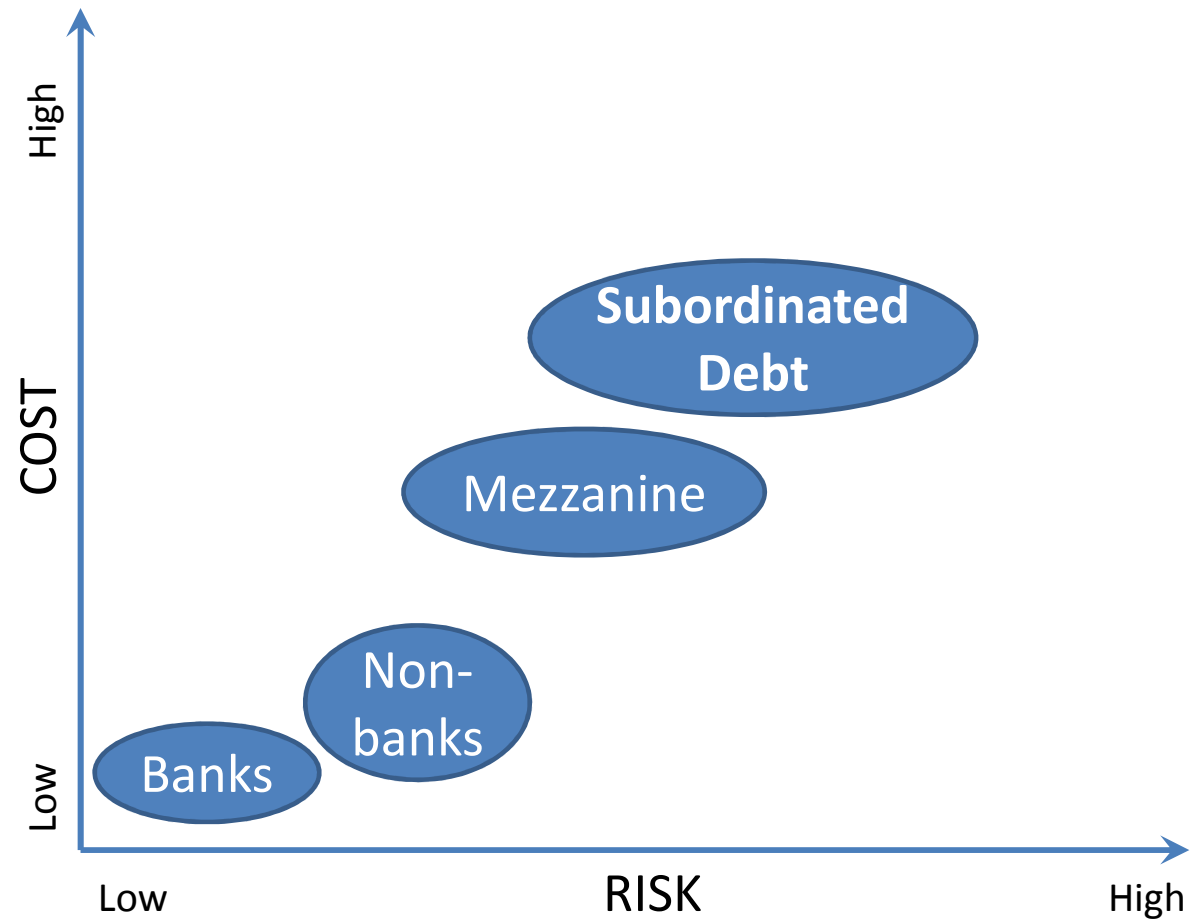
Step 5b:

Arrange Financing

Sources:

Subordinated Debt

- Interest only for 4-5 years
- Behind other lenders in repayment priority
- Bank rates +5 to 15%
- Junk bond





How to earn impossible to ignore wealth?

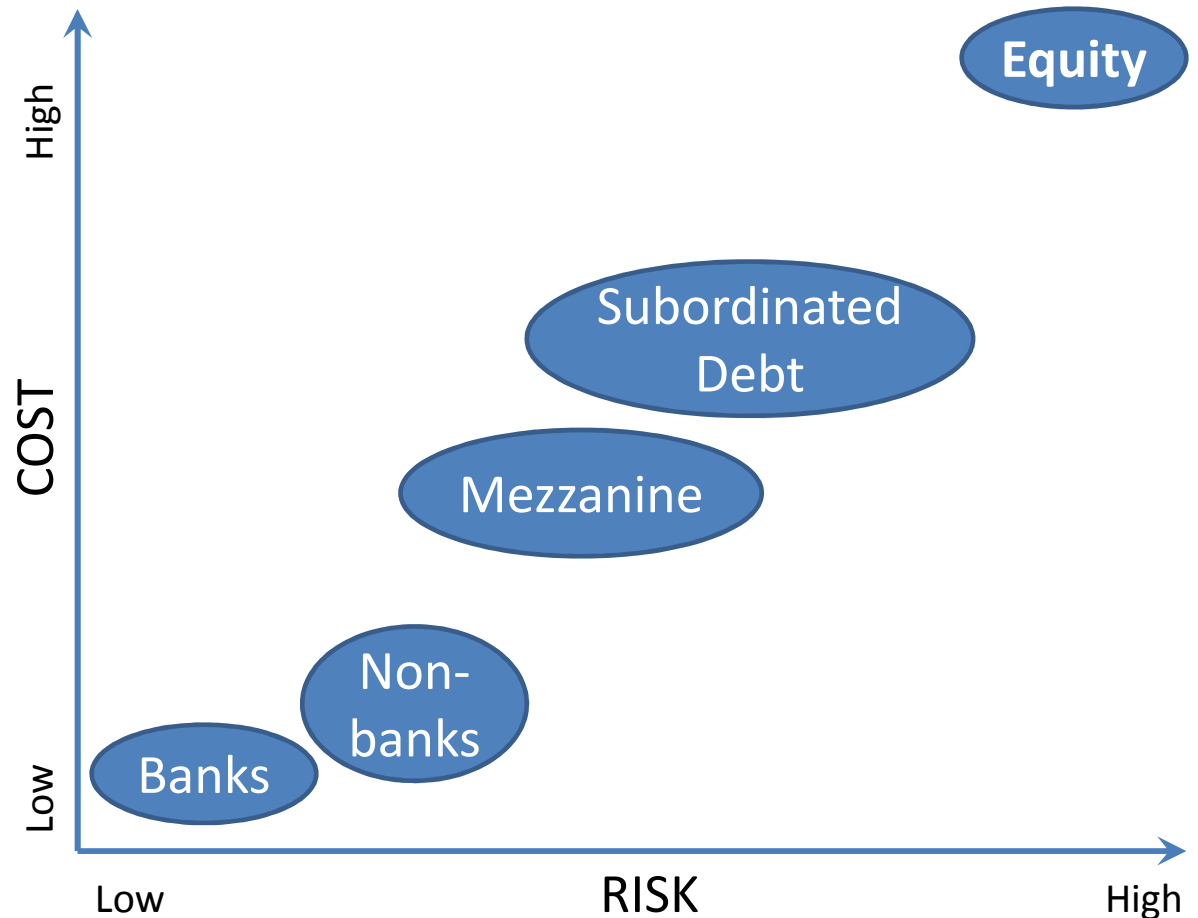
Step 5b:

Arrange Financing

Sources:

Equity Investment

- No interest or principle
- Last to be paid, if bad
- Expect > 40% return per year
- May restrict what you are able to do with TOC



How to earn impossible to ignore wealth?

Step 5c:

Write business plan

To get financing

- Book – inches thick
- Explains acquisition strategy
- Shows expected financial results





How to earn impossible to ignore wealth?

Step 5c:

Write business plan

How much should you earn in one year?

		Acquisition				
		<u>Before</u>	<u>After</u>	<u>Change</u>	<u>Next Year</u>	<u>Δ</u>
Sales		\$23.0				
T		3.7				
OE		2.6				
EBITDA		1.1				
Tax & Int		0.50				
NP		0.60				



How to earn impossible to ignore wealth?

Step 5c:

Write business plan

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Sales	\$23.0		
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EBITDA	1.1		
Tax & Int	0.50		
NP	0.60		

← Low Throughput margin



How to earn impossible to ignore wealth?

Step 5c:

Write business plan

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← 4.8% of sales



How to earn impossible to ignore wealth?

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← 2.6% of sales



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OE		2.6				
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Tax & Int		0.50				
NP		0.60				
A/R		\$2.0				
Inventory		4.2				
Bank Debt	4.25%	2.5				
Mezz	14%	0.0				
Interest		\$0.11				
Value (5x)						
Value (6x)		\$6.6				

← 32 days of sales



How to earn impossible to ignore wealth?

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Value (5x)						
Value (6x)		\$6.6				

← 4.6 Inventory turns per year



How to earn impossible to ignore wealth?

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Sales		\$23.0				
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Mezz	14%	0.0				
Interest		\$0.11				
Value (5x)						
Value (6x)		\$6.6				

← Too high a price



How to earn impossible to ignore wealth?

Step 5c:

Write business plan

How much should you earn in one year?

		Acquisition			
		Before	After	Change	Next Year
					Δ
Sales		\$23.0	\$23.0		
T		3.7	3.7		
OE		2.6	2.6		
EBITDA		1.1	1.1		
Tax & Int		0.50	0.97		
NP		0.60	0.13		
A/R		\$2.0	2.0		
Inventory		4.2	4.2		
Bank Debt	4.25%	2.5	3.6		
Mezz	14%	0.0	3.0		
Interest		\$0.11	\$0.57		
Value (5x)					
Value (6x)		\$6.6	\$6.6		

← Borrow to bank's limits



How to earn impossible to ignore wealth?

Step 5c:

Write business plan

How much should you earn in one year?

Best available source →

		Acquisition			
		Before	After	Change	Next Year
					Δ
Sales		\$23.0	\$23.0		
T		3.7	3.7		
OE		2.6	2.6		
EBITDA		1.1	1.1		
Tax & Int		0.50	0.97		
NP		0.60	0.13		
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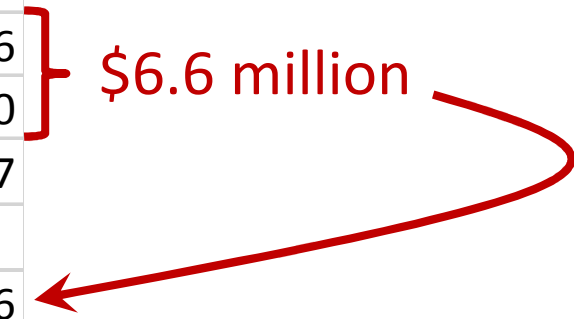
How to earn impossible to ignore wealth?

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How to earn impossible to ignore wealth?

Step 5c:

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Value (6x)		\$6.6	\$6.6			

Drives up interest



How to earn impossible to ignore wealth?

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					Δ
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Interest		\$0.11	\$0.57		
Value (5x)					
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← Ouch!



How to earn impossible to ignore wealth?

Step 5c:

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Hurry! Apply TOC



How to earn impossible to ignore wealth?

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Sales		\$23.0	\$23.0	15%	\$26.5	\$3.5
T		3.7	3.7	15%	4.3	0.6
OE		2.6	2.6	5%	2.7	0.1
EBITDA		1.1	1.1	39%	1.5	0.4
Tax & Int		0.50	0.97		0.92	-0.05
NP		0.60	0.13	1%	0.60	0.47
A/R		\$2.0	2.0			
Inventory		4.2	4.2			
Bank Debt	4.25%	2.5	3.6			
Mezz	14%	0.0	3.0			
Interest		\$0.11	\$0.57			
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Value (6x)		\$6.6	\$6.6			

Availability + Mafia Offer ($\Delta T > \Delta OE$)



How to earn impossible to ignore wealth?

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A/R		\$2.0	2.0		2.0	
Inventory		4.2	4.2		2.8	-1.4
Bank Debt	4.25%	2.5	3.6		3.6	
Mezz	14%	0.0	3.0		1.6	
Interest		\$0.11	\$0.57		\$0.37	
Value (5x)					7.6	2.5
Value (6x)		\$6.6	\$6.6			

Replenishment + DBM



How to earn impossible to ignore wealth?

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Value (5x)					7.6	2.5
Value (6x)		\$6.6	\$6.6			

How much you make in 1 year





How to earn impossible to ignore wealth?

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	Before	After	Change	Next Year	Δ
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Tax & Int	0.50	0.97		0.92	-0.05
NP	0.60	0.13	1%	0.60	0.47
A/R	\$2.0	2.0		2.0	
Inventory	1.2	2.2		2.8	-1.4
Bank Debt	1.5	3.6		3.6	
Mezz	0.9	3.0		1.6	
Interest	\$0.11	\$0.57		\$0.37	
Value (5x)				7.6	2.5
Value (6x)	\$6.6	\$6.6			

Stinks!

How much you make in 1 year





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How to earn impossible to ignore wealth?

Step 5c:

Write business plan

It is easier and less risky to **buy two** (or more) **companies** rather than one



How to earn impossible to ignore wealth?

Step 5c:

Write business plan

It is easier and less risky to **buy two** (or more) **companies** rather than one

RULES: The companies should have these things in common

- Operate in same geography
- Serve the same customers
- Can consolidate facilities & resources
- Products and services have a future



How to earn impossible to ignore wealth?

Step 5c:

Write business plan

It is easier and less risky to **buy two** (or more) **companies** rather than one

		Acquisition				
		Co A	Co B	Combined	Combined	
		<u>Before</u>	<u>Before</u>	<u>After</u>	<u>Change</u>	<u>Next Year</u>
						<u>Δ</u>
Sales		\$23.0	\$12.0			
T		3.7	2.4			
OE		2.6	2.0			
EBITDA		1.1	0.4			
Tax & Int		0.50	0.14			
NP		0.60	0.26			



How to earn impossible to ignore wealth?

Step 5c:

Write business plan

It is easier and less risky to **buy two** (or more) **companies** rather than one

Acquisition					
	Co A	Co B	Combined		Combined
	Before	Before	After	Change	Next Year
					Δ
Sales	\$23.0	\$12.0	\$35.0		
T	3.7	2.4	6.1		
OE	2.6	+ 2.0	≠ 3.5		
EBITDA	1.1	0.4	2.6		
Tax & Int	0.50	0.14	1.37		
NP	0.60	0.26	1.23		

← If you followed the 4 rules, there are synergies from working out of one building and selling to the same customers ($\Delta T > \Delta OE$)



How to earn impossible to ignore wealth?

Step 5c:

Write business plan

It is easier and less risky to **buy two** (or more) **companies** rather than one

Acquisition					
	Co A	Co B	Combined		Combined
	<u>Before</u>	<u>Before</u>	<u>After</u>	<u>Change</u>	<u>Next Year</u>
					<u>Δ</u>
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OE	2.6	2.0	3.5		
EBITDA	1.1	0.4	2.6		
Tax & Int	0.50	0.14	1.37		
NP	0.60	0.26	1.23		

← Nice



How to earn impossible to ignore wealth?

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		Acquisition			
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EBITDA		1.1	0.4	2.6	
Tax & Int		0.50	0.14	1.37	
NP		0.60	0.26	1.23	
A/R		\$2.0	\$1.5	\$3.5	
Inventory		4.2	2.4	6.6	
Bank Debt	4.25%	2.5	0.0	5.9	
Non-reg.	6%	0.0	0.0	3.1	
Interest		\$0.11	\$0.00	\$0.44	
Value (5x)					
Value (6x)		\$6.6	\$2.4	\$9.0	

\$9.0 million



How to earn impossible to ignore wealth?

Step 5c:

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It is easier and less risky to **buy two** (or more) **companies** rather than one

Acquisition							
		Co A	Co B	Combined		Combined	
		Before	Before	After	Change	Next Year	Δ
Sales		\$23.0	\$12.0	\$35.0	15%	\$40.3	\$5.3
T		3.7	2.4	6.1	15%	7.0	0.9
OE		2.6	2.0	3.5	5%	3.7	0.2
EBITDA		1.1	0.4	2.6	204%	3.3	0.7
Tax & Int		0.50	0.14	1.37		1.98	0.61
NP		0.60	0.26	1.23	127%	1.36	0.13
A/R		\$2.0	\$1.5	\$3.5			
Inventory		4.2	2.4	6.6			
Bank Debt	4.25%	2.5	0.0	5.9			
Non-reg.	6%	0.0	0.0	3.1			
Interest		\$0.11	\$0.00	\$0.44			
Value (5x)							
Value (6x)		\$6.6	\$2.4	\$9.0			

Same TOC applied



How to earn impossible to ignore wealth?

Step 5c:

Write business plan

It is easier and less risky to **buy two** (or more) **companies** rather than one

		Acquisition					
		Co A	Co B	Combined		Combined	
		Before	Before	After	Change	Next Year	Δ
Sales		\$23.0	\$12.0	\$35.0	15%	\$40.3	\$5.3
T		3.7	2.4	6.1	15%	7.0	0.9
OE		2.6	2.0	3.5	5%	3.7	0.2
EBITDA		1.1	0.4	2.6	204%	3.3	0.7
Tax & Int		0.50	0.14	1.37		1.98	0.61
NP		0.60	0.26	1.23	127%	1.36	0.13
A/R		\$2.0	\$1.5	\$3.5		3.5	
Inventory		4.2	2.4	6.6		4.2	-2.4
Bank Debt	4.25%	2.5	0.0	5.9		5.9	
Non-reg.	6%	0.0	0.0	3.1		0.6	
Interest		\$0.11	\$0.00	\$0.44		\$0.29	
Value (5x)						16.7	\$10.1
Value (6x)		\$6.6	\$2.4	\$9.0			

Same TOC applied

4x the outcome



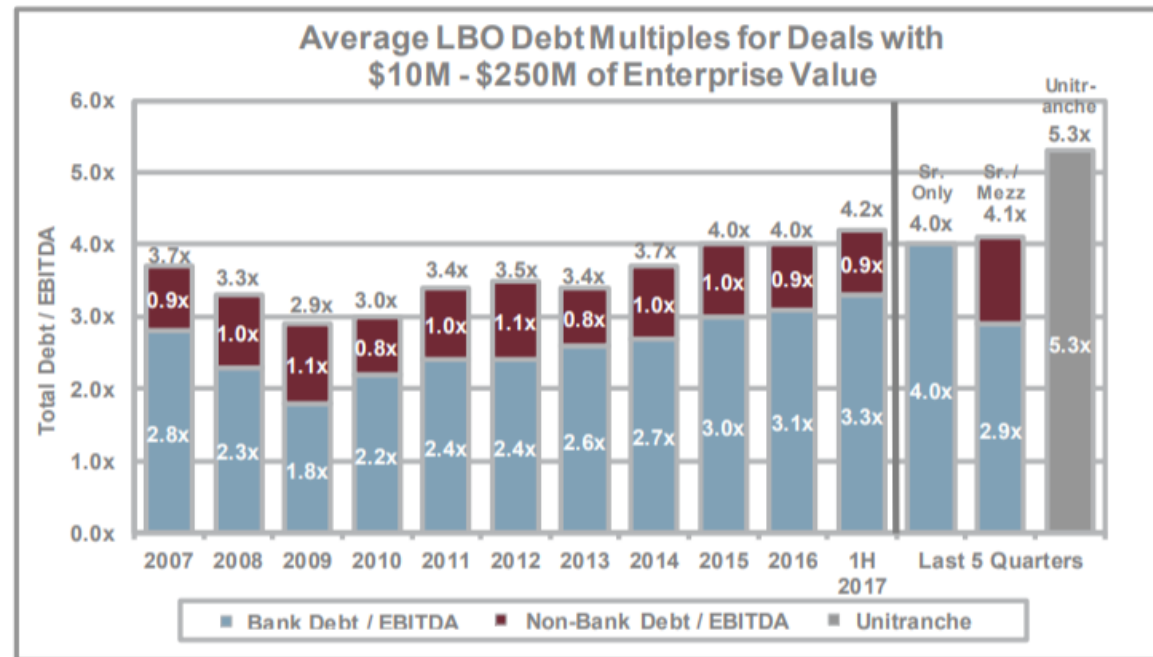
How to earn impossible to ignore wealth?

Review:

Buy a platform and add companies to it

- It is easier and less expensive to **buy two** (or more) **companies**
 - You can easily and inexpensively borrow 4x future EBITDA with no money down
 - Buying 2 companies with synergies gets EBITDA up so 4x is all you need

SENIOR DEBT AND TOTAL LEVERAGE REMAIN STRONG



Source: GF Data®



How to earn impossible to ignore wealth?

Review (conclusion):

Buy a platform and add companies to it

- **Buy High → Sell Low**
 - Time lost applying TOC is worse than the extra money paid – let the deal happen
- **Protect the culture you want**
 - Adopt new people quickly
 - Help the ones you don't need find new jobs



Theory of Constraints Practitioners Alliance

www.tocpractice.com

About the presenter

Henry Fitzhugh Camp

Why?: Improve the world

How?: Take advantage of the fact that few people know about Theory of Constraints in order to increase adoption

What?: Buy and improve companies
(I currently own 5 – working on the 6th)

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