The Bigelow Company LLC
Established 1935

CONSEQUENCES OF PERSPECTIVE

"Perspective" is a powerful concept. We've all heard, "It all depends on how you look at it."

Consider the case of some friends. When embarking on the challenge to find and close a transaction with the best new majority investor for this building products company a few years ago, all of their internal dashboard indicators were bright Green—GO! Revenues were up year-over-year, EBITDA margins were growing, and the next year was forecast to hold even more promise. The owners of the business were "working foremen", a group of entrepreneurs, all of whom were employees in the business, each responsible for a key functional area. There were six of them, all with varying individual amounts of non-controlling ownership in the combined business.

After a proactive engagement of positioning the Company to the "best fit" Strategic and Financial Investors, seven or eight offers emerged in the $40 million to $50 million range, along with a customary amount of "rollover" or reinvestment of ownership. This range of seven or eight offers, with a spread at about 50% around the median, was more tightly grouped than most in our experience.

Now here's where "perspective" started to matter: with forecast EBITDA at $7 million, and "leading" companies in the building products industry receiving all-time high Enterprise Value-to-EBITDA multiples of 8X, (some of) the owners were disappointed with the range of offers. Thinking as managers, they focused on internal measures and processes. Their "perspective" was that by "tweaking" mechanistic internal company performance, and assuming industry cycles would go on indefinitely, in a few years they would "get their number". Thinking like owners would have caused them to consider the big picture, to assess the competitive landscape, changing customer relationships, and rapidly changing drivers of demand. They elected to pass on the offers. You're probably realizing this story regrettably doesn't have a happy ending.

On the other hand, many of our most successful clients share a psychological perspective best captured by a quote from one such owner-manager: "Don't talk to me about coulda, shoulda, woulda, someday, maybe. Look, the $50ish million offer for this business is a helluva win considering I started with a $25,000 second-mortgage on my home!" Instead of measuring the distance to a fictional horizon (which, by definition, will always remain unreachable in the distance), this successful entrepreneur looked back from where he actually started from…and savored the satisfaction of recognizing the tremendous accomplishment of his journey, for himself, his family, and for his other stakeholders.

How could these battle scarred successful entrepreneurs ignore the big picture you ask? Because as humans, we are not rational, utility maximizing animals—we are natural pattern seekers. Consequently, when something is going up, we expect it to continue to go up. This results in a strong bias to overweight recent events and extrapolate them into the future (instead of reverting to the mean which is what actually takes place). Look, the 2007-2009 recession was harder on some industries than others, and without a doubt, the tide went out real fast on the commercial and residential construction industries. Who could have predicted it? Since then, even with the best of intentions and herculean effort, the company's EBITDA went negative, bank covenants were violated, and the continuing existence of the business is in jeopardy, with certainly no remaining equity value for the six stockholders.

When we ask these friends what lessons we can learn from their scar tissue, they say this: first, what matters most is the big picture environment of the industry you are in; second, remember that inaction has consequences too; and third, to maximize subjective wellbeing, set your goals by looking forward, but measure progress looking over your shoulder at where you actually started from.

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