"WALKER IS THE REAL DEAL, AND HE SHARES HIS INSIGHTS FOR RUNNING A SUCCESSFUL COMPANY FROM DAY ONE."

—SHEP HYKEN, *NEW YORK TIMES* BESTSELLING AUTHOR OF *THE AMAZEMENT REVOLUTION*

BUY THEN BUILD

How Acquisition Entrepreneurs Outsmart the Startup Game

WALKER DEIBEL

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ADVANCED PRAISE FOR *BUY THEN BUILD*

"Looking back 20 years from now, acquisition entrepreneurship will be as normal as going to law school today. In the meantime, it's a huge opportunity to hop on the train before the secret gets out and Walker explains exactly how to do that."

—TAYLOR PEARSON, bestselling author of *The End of Jobs*

"Walker is playing it smart. He sees opportunities others don't."

—CLIFF HOLEKAMP, Director of Entrepreneurship, Washington University in St. Louis, and cofounder, Cultivation Capital

"*Buy Then Build* clearly outlines the framework for capturing value through acquisitions."

—MARK DAOUST, founder, Quiet Light Brokerage

"*Buy Then Build* is a practical guide to cash flow investing, business, or improving financial IQ. I recommend this book to all of our clients."

—GARRETT GUNDERSON, NYT Bestselling Author of *Killing Sacred Cows* and Founder, Wealth Factory

"*Buy Then Build* has already been called superb, enlightening, and inspirational. I can't say anything better!"

—TOM WEST, cofounder, Business Brokerage Press and IBBA

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FOREWORD

BY CHAD TROUTWINE

ONE BRISK SPRING MORNING IN 2011, I ARRIVED AT MY MALIBU beachfront office to find a film crew waiting to interview me. They explained that they were there to film a promotional video for Corley Printing, Walker Deibel's very first buy-then-build success story. I had no memory of agreeing to do any such thing (and still don't), but that occasionally happens to me. Whenever I agree to do something far into the future, I just say yes and imagine the day will never come. But this time, the day had come and it was today. As a person worthy of being the star of a micro-budget promotional video, I had a hundred more important things to do that morning. I would have weaseled out of the shoot (or at least changed into a more stylish outfit), but I truly loved Corley Printing and their dynamic young CEO, so with a broad a smile, I said, "Mic me up, fellas!"

Just as most everyone under fifty years old was running from anything having to do with the printing industry, Walker had gone against the grain and actually acquired a book manufacturing company. I got a front row seat to watch as he made decisions that transformed the company, and quickly became a regional leader in digital book production—perhaps the only area that was growing under the changing printing landscape. Under Walker's leadership, the company withstood the storm that hit the industry, became one of the largest 2 percent of printing companies in the United States, and experienced an exit.

Walker is more than just an author, and *Buy Then Build* is more than just some academic exercise. This book is an insider's look into a proven system, masterfully told by a veteran entrepreneur. Walker has already found success several times buying and building businesses. Just as the practice of entrepreneurship through acquisition is taking hold in business schools, Walker—if you'll forgive the obvious pun—is not just talking the talk; he has already walked the walk.

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HIDDEN IN PLAIN SIGHT

Before I moved to California, I spent my childhood in suburban Kansas City, Missouri. No one I knew ever used the phrase “entrepreneur” to describe their job. Instead, folks used the much more modest description, “small business owner.” Even as a child, I could tell theirs was the path for me (and not just because they tended to live in the biggest homes in the neighborhood). The businesses weren’t glamorous—metal fabricating shops, car dealerships, local newspapers—but they looked fun, and I could see the value they provided to our town. As I grew older, I learned to appreciate the distinction between launching a startup and running a small business. They both have their appeal, but lately people seem to be over-hyping the former and deeply underappreciating the latter.

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A CONTRARIAN PERSPECTIVE

Billionaire investor Peter Thiel is fond of asking people, “What important truth do very few people agree with you on?” Walker shares a fantastic answer in *Buy Then Build*: ambitious entrepreneurs should buy an existing company and use it as a platform to build value, rather than start a business from scratch. There are three primary reasons:

1. Startups have a little flaw: they mostly fail.
2. Existing companies have the established infrastructure that many startups are trying to build in the first place.
3. Acquisition entrepreneurs should match their resources and talent to transitioning businesses to create significant value in a company all their own.

Fortunately for you, Walker was not content with simply offering up generic advice. Instead he provides detailed, step-by-step instructions on how to buy then build your business. He compellingly makes the case that existing businesses offer an inherent advantage because they provide a profit-generating infrastructure, a pool of existing customers, an operational history, and experienced employees. Walker explains how to define your search and excel based on opportunity and discretionary earnings, rather than simply following the herd with business search tools that leave many would-be buyers never reaching success. He shares advice on how to navigate a deal, offers insight into what to expect from the seller, and even provides guidance on what your transition to CEO might look like.

Walker is one of the most important influences on my professional life. Through the pages of this superb book, he will enlighten, delight, and inspire you. *Buy Then Build* is a blueprint to constructing your own masterpiece. And you might even end up starring in a promotional video for it one day.

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PART 1

OPPORTUNITY

"No army can withstand the strength of an idea whose time has come."

—VICTOR HUGO

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CHAPTER 1

DON'T START A BUSINESS

"IT'S DEAD."

John was the former director of product management for Microsoft Services and now acted as the CEO of our startup, ViewPoint. He was referring to our company. "We're out of cash, the product isn't functional, and we don't have any paying customers. It's over."

This wasn't my first startup. Or even my first startup failure. I understood the risks—indeed, after having a previous startup fail, I thought I had learned the variables that lead to a successful launch. This time was going to be different.

We not only had a great product in a fast-growing market, but an all-star team. Our largest investor was a former Fortune 500 CEO. Our own CEO had been the SharePoint consulting executive at Microsoft and had worked with customers directly in our target market. Our team of proven, high-revenue-generating developers had built successful enterprise software before, and one of our advisors was a CTO of a Fortune 500 company. The equity raise was oversubscribed, and within months of graduating from one of the top-ten startup accelerator programs in the world we had beta trials inside many recognizable companies. We had all the hallmarks of success…but no actual success.

Startups have an inherent flaw: they mostly fail. Even with overwhelming talent, outstanding early product trials, and an all-star team, success is still unlikely. We've all heard the statistic that one out of ten startups make it. It's not a secret. We all go in with two eyes open. It appeared that ViewPoint was no exception.

The goal for entrepreneurs is to run and operate a successful business. The

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goal for investors is to make money by investing in a successful business. There's just one problem—the startup phase is a company killer.

Data suggests that, at best, only half of all startups make it past this stage. Those that do often come out not looking like Uber, but more like a small business. As Verne Harnish, author of *Scaling Up*, observes, only 4 percent of all companies in the United States ever exceed $1 million in revenue.[1] It's odd to me that despite the interest in entrepreneurship, we really haven't engineered a better way to avoid the startup runway and build sustainability into startups from the beginning. When we drill down into the numbers on this level, we're left with the stark fact that somewhere well north of 99 percent of all startups either fail completely, or never really amount to much—either financially or impactfully.

What if there was a way to establish success from the beginning? An "entrepreneurship hack," so to speak. A path that could bypass the startup phase altogether, so entrepreneurs could start operating a successful business as the Chief Executive Officer from day one. This would provide an immediate platform to add value from. You could grow it, run it as is, or use the cash flow from the company to fund the creation of new products or services.

This exists, and it's called *acquisition entrepreneurship*.

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ACQUISITION ENTREPRENEURSHIP

Acquisition entrepreneurs start by buying an existing business instead of starting one from scratch. From there, they bring an entrepreneurial approach to build value. The combination of an existing small business' profitable and sustainable infrastructure with the innovation and drive of an entrepreneur is a magical recipe.

The main benefit of acquisition entrepreneurship is that existing companies are already established with customers, brand awareness, employees, and most importantly, revenue and profits—everything a startup doesn't have.

Instead of having to raise money for months (often *years*) while also trying to build sales from scratch with a new product, the acquisition entrepreneur acquires a profitable infrastructure from which to begin. Existing businesses provide established markets, so they don't have to worry whether they are too early or whether another company with more funding will beat them to market share—or in some cases, worry about *creating* a market from scratch. Simply by buying a company, typically one greater than $1 million in revenue, you can remove so much of the risk inherent to entrepreneurship.

Further, many successful small businesses have been operating for decades. This means their model for success was developed a long time ago, and many of these businesses could benefit from the fresh approach and skillset of the next generation of entrepreneurs. There is a lot of opportunity inside small companies that operate on legacy systems, never upgraded to lean business models, or never developed sales teams or effective online marketing.

Following ViewPoint's capitulation,[2] an advisor who helped me exit my previous company found a print management and distribution company that he thought would be a good fit. The company was selling a few million in revenue and had a handful of noteworthy, highly-respected, and well-known clients.

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Through our analysis—although print management and centralized “brand control” was valuable to its customers—we decided that the real core competency of the business was in its inventory management and fulfillment capabilities, which provides its customers the benefits of lean supply chain management practices. It was clear that the product lines could be easily expanded.

Indeed, one of the biggest clients came to the seller and asked if he could put other products important to their supply chain into the online ordering system. We saw the potential to build a true business-to-business fulfillment company from the existing infrastructure, providing a private and customized “Amazon-like experience” for companies with multiple locations.

I acquired the company in early 2015 with a low six-figure investment and a bank loan. After the closing, and with the cash flow from the company, we hired part-time software engineers and created a proprietary eCommerce storefront, which we quickly rolled out to tens of thousands of users nationwide—*everything we had tried but failed to achieve at ViewPoint.*

They were thrilled. Instead of an “online system,” they now had a user-friendly website that didn’t require training. Headquarters provided real time tracking metrics and accounting codes for their internal accounting system. We also implemented procedures that proactively managed inventory, which increased on time delivery of goods and confidence with the existing customer base.

In the first eleven months, my team more than doubled the marketable value of the company, simply by bringing a complimentary level of innovation into an established and stable business.

To fuel the fire even further, I acquired a local promotional and corporate apparel business the following year. We merged it into the fulfillment company, giving it an immediate 20 percent revenue boost and an additional 500 customers. This too was funded by the cash flow of the business I had already acquired.

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The venture was a clear example of the power of acquisition entrepreneurship. While we failed to get enough paying users at ViewPoint—despite lots of capital, a beloved and innovative product, and a ridiculously accomplished team—I was able to achieve the same end goal by acquiring a successful business and then using the cash flow to innovate and upgrade the offering and the talent. This was accomplished at a fraction of the cost and a fraction of the time, and provided 100 percent ownership of the company.

Moreover, this was not the first time I had done business this way. Over the past ten years since then, I've acquired seven different companies and made minority investments in more. These have included book printing, distribution, promotional product companies, eCommerce, education, and metal fabrication and finishing. All of them had growth opportunities for those who could identify them and who understood acquisition entrepreneurship. I bought these businesses because I believed I, or my team, could add value to them.

I've been lucky. I've navigated it fairly well and, most of the time, made them more valuable than when I bought them. I've even been fortunate enough to experience a successful exit through this process—the crown jewel achievement of all startups.

Practicing acquisition entrepreneurship flips the startup model on its head. Instead of building the infrastructure and then working to find the revenue to support it, it seeks profitable revenue first. By doing so, the startup runway is eliminated, allowing for immediate focus on activities that improve an already successful enterprise. Activities like managing, innovating, and growing the company start on day one.

Compare this to raising capital by selling company stock while simultaneously trying to find product/market fit…all while under the stress of managing a cash flow negative burn. It's no wonder startup founders sometimes confuse equity investment with revenue.

There are roughly 500,000[3] small businesses acquired each year. These acquisition entrepreneurs are skipping the startup phase altogether, unlocking trillions in value, and living the successful entrepreneur lifestyle.

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ACQUISITION IS MORE AFFORDABLE THAN YOU THINK

I can hear you already. “I could never do this because I’m not rich.”

First, I’d say that in my experience, very few entrepreneurs raising capital to launch startups are rich, so I’m not sure the comparison is all that valid. That said, and although brokers typically want to see a few hundred thousand in available cash, it’s the nature of buying an existing business that makes it much easier to gain access to capital.

Banks offer loans to buyers for up to 90 percent of the purchase price, using the assets of the business as collateral. Remember I mentioned raising capital takes a fraction of the time? The financing of these deals is typically done in one fell swoop, with you bringing a “down payment” or “equity infusion” and the bank providing the balance.

In addition, raising money from a bank also means that you get to own 100 percent of the company yourself.

If you require investors or other backing for the initial equity infusion, you have options. You can bring on partners, raise from friends and family, or pitch family offices or angel investors who will be attracted to the better economics when compared to startups. There has also been an increasing trend in new search funds. These funds are dedicated to helping acquisition entrepreneurs buy businesses. These funds can also assist in helping you acquire significantly larger companies than you could do on your own, effectively allowing you to stretch well into the middle market (which I’ll define here, as those companies generating between $5 and $100 million in revenue[4]) or provide additional capital to lower the debt profile.

All in all, buying a business is way more affordable than you think. In terms of initial capital required by the entrepreneur, it looks amazingly comparable to either starting a company or buying a house. Let me explain.

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Babson College statisticians reported through the *Wall Street Journal* that the average startup in the US kicks off with $65,000 in invested capital. Similarly, the average down payment on a home for the last three years[5] was approximately $57,000, with the twenty-five counties experiencing the biggest increase in millennials[6] averaging $66,174. So, whether people are starting a business from scratch or buying a house, they are investing somewhere around $65,000.

Because companies under about $10 million in revenue tend to sell for lower multiples than middle-market or publicly traded companies, a $65,000 investment, paired with a 90 percent loan backed by the small business administration, could buy a company generating over $1 million in revenue, immediately launching an acquisition entrepreneur into the role of CEO of one of the largest 4 percent of companies in the US.

In loose math it would look like this (and to simplify, let's assume this equation does not include working capital, inventory, closing costs, or real estate):

$65,000 invested plus 90 percent SBA loan equals a $650,000 purchase price.
A company of that size is commonly acquired around a multiple of three times adjusted earnings.[7]
Adjusted earnings therefore are $216,000 ($650,000 divided by three).
Assuming a 15 percent adjusted earnings-to-revenue ratio, this company is generating over $1.4 million in revenue.

There are a lot of assumptions in a back-of-the-napkin calculation, but here the goal is to illustrate that an investment similar in size to starting a business from scratch or buying a house can instead be used to acquire a sustaining business generating profitable revenue with an existing infrastructure. There will be additional costs, but the takeaway is that it is absolutely achievable to acquire a company of this size with less than $100,000.

Rethinking how we approach entrepreneurship requires some tweaking of

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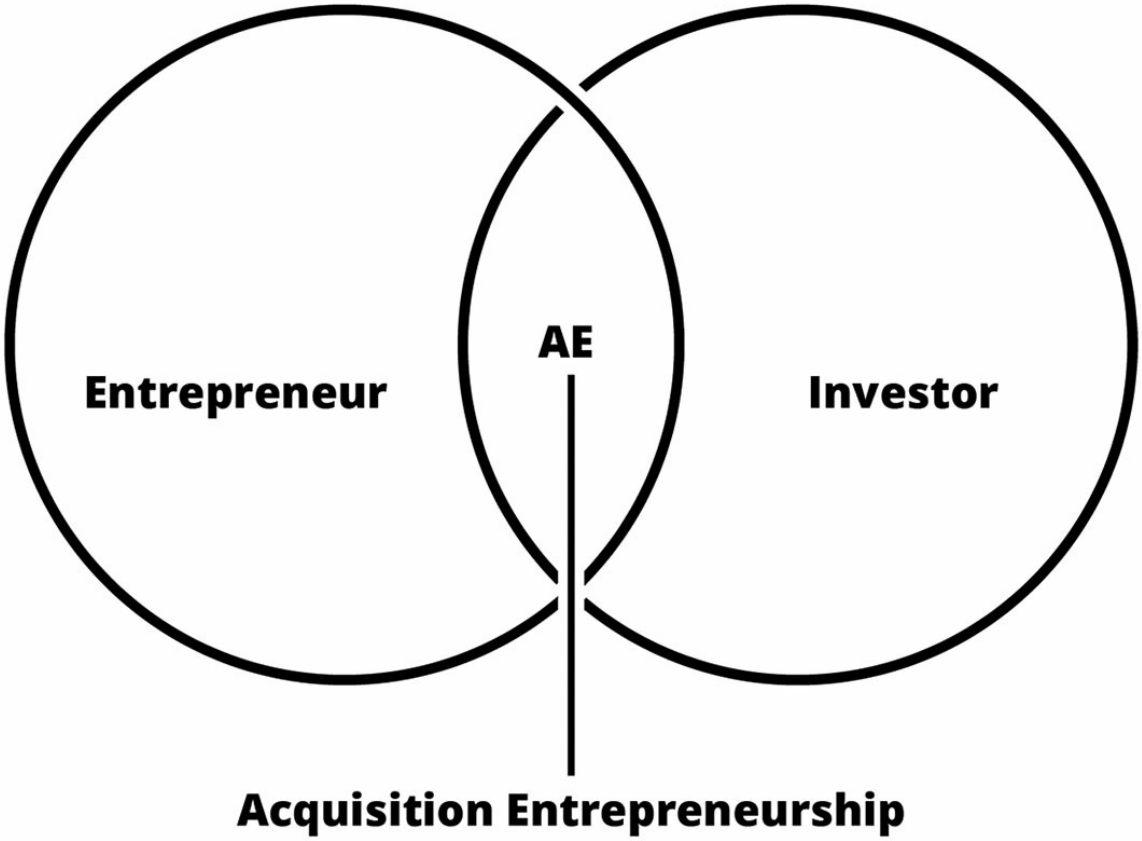
skillsets. Not as much in eliminating and adding, but rather the order in which they are mastered. Like all business professionals, acquisition entrepreneurs need to be a hybrid of investor and entrepreneur mentalities. As a first-time entrepreneur builds out their business plan, they quickly realize the need to be able to understand how to think like an investor in order to create a sustainable business and provide returns for the capital used to build the infrastructure to begin with.



What's different about an acquisition model is that the entrepreneur needs to think and act as an investor before getting started. This engineers stronger, more sustainable companies and better entrepreneurs. In the illustration above, we outlined a $65,000 initial investment, generating over $200,000 in discretionary earnings to a buyer. It will be the investor mindset that will need to evaluate whether this is a good financial decision,[8] and to analyze the

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business’ opportunity. As an entrepreneur, you’ll be looking for an opportunity that is a fit for you, as well as something that has personal interest.

This means that the acquisition entrepreneur will need to learn how to manage and operate an existing company, simultaneous to being able to focus on innovation alone. These are skills that all successful entrepreneurs need to master as they move from creator to CEO, but the order in which they are addressed here is reversed—starting instead as CEO on an existing business, then bringing innovation, updates, and growth from there.

By combining an investment in the existing revenue, infrastructure, and earnings with the drive and innovation fueling the entrepreneur, acquisition provides a powerful recipe, allowing existing companies to go to new heights, having tremendous impact, and providing a platform for the entrepreneur’s art.

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ACQUISITION ENTREPRENEURSHIP VERSES VENTURE CAPITAL

Acquisition entrepreneurship is not right for every circumstance or everyone. After all, certain entrepreneurs have enjoyed such remarkable success that they have obtained celebrity, even legendary status. We're all familiar with the titans of technology who dominate the business media: Bill Gates, Steve Jobs, Jeff Bezos, Mark Zuckerberg, and Elon Musk, to name a few. These guys didn't start by buying a company, so why should you?[9]

Lately, it's been the startups able to get to the billion-dollar valuation, the "unicorn" companies, in the limelight. These companies are changing how we live and work, and they are not only creating tremendous value but are introducing new business models. Indeed, all startups today aim to be the "Uber of [enter your industry here]," right?

All these companies sourced venture capital (VC) to launch their companies. If we have engineered a better way to start from scratch, it probably looks a lot like this. The average successful VC-backed startup raises $41 million. That's a lot of money and must solve a lot of problems.

According to Harvard Business School lecturer, Shikhar Ghosh, even VC-funded startups—the ones that every MBA startup strives to attain—have a 75 percent *failure* rate. So, extremely well-financed startups with the support of the best investment teams in the world are successful in doubling the already minuscule success rate of non-VC-backed startups. But the large majority of these companies still never make it to sustainability.

The VC game is one of portfolio management. Meaning there needs to be a sizeable enough portfolio for VC backing to make sense. This is why, as of 2008, the average VC fund is $350 million.[10] This provides capital for eight to fourteen companies per fund. Three winners pay for the fund and it's return, while nine entrepreneurs get a shot "at bat" in a game that only

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accepts home runs. As an investor, you might like this game. Lots lose, but the few that win provide exceptional returns for you.

As an entrepreneur, you need to understand that you are not invested in the portfolio. You are invested in a specific company, so the economic advantages gained by the VC are not extended to you, and there is a very quantifiable 75 percent chance that your specific company will be a loser. It turns out, for the entrepreneur, VC isn't all it's cracked up to be.

I share this not to crush the dreams of entrepreneurs everywhere but to share insight into what engineering success might actually look like. Understanding that unicorn companies are more anecdotal than typical is simply a prerequisite. Starting a VC-backed company believing that you will be the next magazine cover success story is possible. But it might just be punishment for not understanding statistics.

Many believe that these high profile, fast growing companies are the ones driving the economy and new jobs. They do drive *trends* by placing significant bets on adolescent markets, but it's not actually where growth comes from.

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WHERE GROWTH REALLY COMES FROM

In 1979, economist David Birch revealed that small businesses are responsible for creating the large majority of new jobs in his statistical report, *The Job Generation Process*. After release of the report, Birch continued to refine his findings, eventually settling on the term “gazelles” to define the 2–3 percent of companies that create 70 percent of new jobs every year.

Gazelles are defined by rapid growth and not size. To be classified as a gazelle, a company must have a starting revenue of at least $1 million, then grow at a rate of 20 percent every year for four years, resulting in the company doubling in size during that time.

Gazelles as job creation vehicles beat out the elephants (Fortune 500, think Wal-Mart or ExxonMobil) and mice (Main Street), which perhaps is a bit of a non-applicable comparison since the latter is defined by size instead of growth rate, so either could exist as a gazelle. That said, most gazelles are found neither on Wall Street nor Main Street, but in the middle market.

When forced to think of a gazelle, you might be tempted to think of technology companies. After all, isn’t tech synonymous with high growth? Well, in the 1990s, yes. Zoltan Acs, director of the Center for Entrepreneurship and Public Policy at George Mason University, released his findings in 2008 that supported the notion that there were more gazelles in the tech industry in the 1990s than any other industry. However, in the 2000s, the leading industry was housing-related services.[11] I can speak to this myself, since our aluminum railing company grew at over 38 percent in 2017. Hardly high tech.

Acs observed that gazelles are found in all industries. Birch supports these observations highlighting that about a third of gazelles are found in wholesale and retail, and a third in the services industry. *Inc. Magazine* recognized this trend as well, publishing an article that compared their celebrated *Inc.* 500 companies to gazelles, recognizing that only 47 percent were tech related

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back in 2000.[12]

Sizable, to be sure, but the *Inc.* 5000 list only requires a $100,000 in revenue starting point—a tenth of the size of gazelles. Further, only 7.3 percent of the *Inc.* 5000 in 2016 were in the computer hardware or software industries. This is indicative that tech-related companies might have an edge in the "not failing" category, but find their place in the masses quickly thereafter. More likely, technology plays an important role in a company's productivity, but delivering high-tech products and services doesn't make it any more likely that a company will continue to be healthy in and of itself. After all, Acs' findings report that a mere 2–3 percent of all companies ever reach gazelle status, and none of them stay there forever.

One of Acs' findings could be surprising to fans of the "fast growth is only found in startups" myth. During a 2009 interview with Forbes, Acs revealed that *gazelles tend to be twenty-five years old*. These are the economy's most productive enterprises—and they're clearly not new companies coming out of accelerator programs. Instead, these are established, long-time companies.

Further, and contrary to popular belief, one researcher found there was a better way to dominate new industries, rather than fighting an incumbent with a new, disruptive offering.

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THE PATH TO DOMINATING NEW INDUSTRIES

An existing company with legacy systems and an outdated path to success has just as much need for innovation as a startup does. As a result, those who can recognize and execute this can capitalize on the benefit of an existing platform to build in the "new company" they wish to run.

Consultant and bestselling author Jim Collins examines what causes companies to succeed or fail. His book, *How the Mighty Fall*, is a guide to understanding a company's various stages of decline and becoming better equipped to reverse the tide.

As we've seen in established companies like Blockbuster and Borders, all established organizations are vulnerable to missing an innovative trend. Collins explains how existing businesses that are able to embrace the disruptive technologies attacking them actually have a *better* rate of dominating the newcomers.

In fact, it's the old dogs with new tricks that have a higher probability of withstanding disruption within their markets. The old dogs have the benefit of existing revenue and earnings. They have infrastructure and invaluable industry insight. They have customers wanting to update to the trends.

It's testament that the challenges startups face never really go away, and that having infrastructure generating profitable revenue is the best possible tool for innovating. It's the combination of innovation and existing customers that wins in the war of disruptive technologies.

Realizing that venture capital might not be the best resource for engineering a successful company, and pairing that with an understanding that the strongest growth is actually more commonly found in established industries, lends itself to some of the advantages of starting with acquisition. What does all this mean for today's would-be entrepreneurs?

Luckily, there happens to be a once-in-history opportunity occurring right now.

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THE $10 TRILLION TSUNAMI

The baby boomer generation owns more businesses than any other generation ever in history.

In 2013, they owned 12 million small businesses, which is 43 percent of all small businesses in the country.[13] That same year, they also started to retire at a rate of 9,000 per day.

The rate in which boomers are retiring is going to increase significantly over the next eighteen years. By 2021, baby boomers will be retiring at a rate of 11,000 per day. Almost 77 million people, about 20 percent of the US population, are going to retire between 2013 and 2029, and it is estimated that $10 trillion in existing business value[14] will need to change hands.

The boomers are already selling off their established, successful small businesses at record rates.[15] These businesses provide an unprecedented opportunity for acquisition entrepreneurs to focus on running, growing, and innovating a business *immediately*, all while enjoying a stability not found in startups.

This substantial increase in supply of available businesses for sale is expected to result in a buyer's market like we've never seen. This means the infrastructure built by generations before will be available for purchase at the most affordable levels ever experienced.

Most people simply don't understand that you can buy a substantial and scalable existing business for under $100,000 down. Couple that with the retiring baby boomer population and we've got a ripe environment for acquisition entrepreneurship to thrive like never before.

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GETTING STARTED

So where do you start? How do you learn how to successfully buy a business?

The idea for this book came to me in 2004 after graduating from a top MBA program. A few of us launched a startup in graduate school, and despite the fact that we performed extremely well in business plan competitions, the company floundered in legal hang-ups during our last semester.

I knew I wanted to own and operate my own company, but I didn't have a compelling idea for a startup, so I started looking for a small business to acquire. I had no money and no idea where to start. There weren't any high-quality resources on the subject, and my world-class MBA education hadn't offered insight into this area.

I tried meeting with business brokers to see what I could learn. Most of them rightly assumed I had very little capital to invest and tried to sell me a downward-trending bar or a laundromat. I discovered a fragmented industry with few rules, zero best practices, little reliable information, and a huge variance in the quality of available opportunities.

Further, business brokers and M&A Advisors[16] are not terribly incentivized to hold the hands of first-time buyers. It's wrong of me to categorize all of them, but unsurprisingly, they are commonly looking for the biggest deals with the biggest fish. They've also been run through the ringer by working with buyers who can't close. So, at minimum they want the confidence to know that they have a buyer who can execute without bank financing, since they won't get paid for months and don't want the added risk of a buyer who can't execute. Like all industries, there are great brokers out there, but it took me years to know where to find them or how to evaluate them.

I needed a high-quality source of information for how to acquire an existing company, but it didn't exist. Acquisition entrepreneurship is not

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taught in most schools. Unless you're one of the fortunate few, lucky enough to participate in one of the very recently developed, top-tier programs at Harvard, Northwestern, University of Chicago, or Stanford, the resources for learning this approach are limited. Instead, I spent the last decade molding a process based on my experiences and now want to share them.

I won't pretend that acquiring a company is not a big deal. It's a significant event. It's hard, it can be complicated, and like anything involving money, it's emotional and risky. In fact, almost everybody who starts down the path of acquiring a business never pulls the trigger. I believe the reason is that they lack a process to get them from where they are today to where they want to go. There is no compass for building a search plan, sourcing deals, evaluating intermediaries, learning what to look out for, or finding the real opportunity in an offer. Often, there are no intimately known examples of others who have done it before you. What if your analysis is flawed or there is a pitfall you're not seeing?

I hope this book (and BuyThenBuild.com) can help solve this problem. It's meant to be the resource that I needed when I started, so I could skip the startup phase, gain confidence, and move right into ownership of a profitable company.

This book isn't limited to my experience alone. I've interviewed and incorporated experiences and research from world-class institutions, investors, private equity managers, and all types of entrepreneurs. The result is a framework unlike anything I've seen anywhere else.

With luck, we can evolve how people think about entrepreneurship and unlock the huge opportunity for more people to be entrepreneurs by leveraging the tremendous value in the existing small business economy.

One more thing: the information is all here, but just reading a book won't do it. You need to commit your time to taking action. You need to commit to investing your own money and betting on yourself. You need to be willing to create a business plan and pitch it to banks or other potential investors.

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Finally, you need to be comfortable and willing to take calculated risks. Although we're paving the way to a greater success rate for entrepreneurs, you are still the most important part of the equation.

Buy Then Build will explore the opportunity available right now in detail and give you a blueprint for building your search process, evaluating deals, and executing the acquisition phase. This is the roadmap for anyone with the drive to take the acquisition entrepreneur path, to become CEO of their own company through buying, then building their business.

First, understand small business as an investment vehicle.

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CHAPTER 2

ENGINEERING WEALTH

According to Thomas Stanley and William Danko, authors of the best-selling book, *The Millionaire Next Door*, effectively 100 percent of non-retired millionaires who live in the United States own their own businesses. Out of that group, about 20 percent are professionals running a medical or service business, and the balance are entrepreneurs and small business owners.

John Bowen, CEO of CEG Worldwide and coauthor of *The State of the Affluent*,[17] concluded through his research that some 80 percent of the affluent are either retired or own their own company. Further, an astounding 91 percent of everyone having over $5 million in net worth owns their own company—a trend suggesting that the wealthier someone is, the more likely they are to own a business.

Owning your own business is not only an opportunity to provide value through products and services, but it's arguably the best way for most people to build real wealth. In this chapter, we'll look at acquisition entrepreneurship as an investment vehicle.

To be clear, this does not mean that after you buy a business you are promised a high net-worth ranking. Nor does it mean that acquiring a company *purely* for financial gain is a good idea. Rather, it points to the fact that being the owner of a successful business can be a great investment vehicle, and that those who make the most of it can finish big.

We've seen that the acquisition entrepreneur needs to act as both entrepreneur and investor. After all, by utilizing the bank instead of private investors for the majority of financing, it puts the responsibility on the entrepreneur to invest their own money into the company. At a minimum, you'll want to understand the basic rules of investing before you start looking at potential acquisitions.

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WHAT MAKES A GOOD INVESTMENT?

Luckily for us, entire industries have been built around investing in alternative assets such as startups and existing businesses—namely, venture capital and private equity. The investment strategies found in real estate investing also hold a fundamentally analogous approach to business buying. That of using leverage along with an initial equity investment to acquire an asset.

But what makes for a good investment?

While considering acquisitions as an investment, keep three fundamentals in mind: return on investment, margin of safety, and upside potential.

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RETURN ON INVESTMENT

The concept of return on investment (ROI) is simple. If you invest $100 and it generates $6 back to you every year, then every year that you own that asset you will receive a 6 percent ROI.[18]

Let's say you sell that asset after seven years. Luckily, it's worth more than when you bought it, so you sell it for $120. During the seven years you owned it, you made $6 every year, or $42. Adding the $20 increase in value of the asset you realized when you sold it, you made a total of $62 on a $100 investment over seven years.[19] This equates to an 8.9 percent annual ROI during the life of the investment ($62/seven years).

Simple right?

Let's break down what just happened. During the seven years of ownership, the asset returned $6 back to you in cash. Let's call this "cash flow," or the amount of cash coming back to you as the owner of the asset.

When you bought the asset for $100 and sold it for $120 seven years later, the value of the asset itself increased during that time. In real estate, this is called *appreciation*. In the illustration above, the increase in value of the asset made up about a third of the total return.

When evaluating a potential acquisition, the cash flow the company generates is what sets the sale price of the company. It's the driver behind the valuation and ultimately what you're paying for. Anything outside of the company's ability to generate cash is commonly not worth paying for at all. At its core, what you are buying is an asset that provides cash flow.

The next logical question then is how much cash flow should a certain investment return? The answer is found in the risk profile of the investment. A United States-backed treasury bond is considered about as safe of an investment as possible. Today, they are generating 2.5–3 percent on invested capital, or enough to keep up with expected inflation during the time of

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ownership, but not much more.

Conversely, a startup is considered one of the riskiest investments around. And rightfully so. As we've seen, the infrastructure, proof of concept, product market fit, and revenue all need to be built from zero. That translates as any return to an investor is unlikely, so the average positive return needs to be very high to compensate for the risk.

A business with under $5 million in revenue and a track record of positive ongoing cash flow for fifteen years is somewhere in the middle. It's significantly safer than a startup, but not nearly as secure as a US-backed security.

The larger a company, the safer an investment is considered. This is because it's easier for a Main Street company to go out of business than a Fortune 500 company. As a result, companies under $1 million in revenue might sell for two to three times their cash flow, while large, publicly traded companies comfortably trade at a price-to-earnings ratio in the twenties or well beyond. You can buy McDonald's or Apple today on the open stock market for eighteen to twenty-five times their earnings.

But what about a small company with under $5 million in revenue?

Depending on the industry, you can expect to pay anywhere from two-and-a-half to six times the total annual cash flow to the owner. That's a big range. The large volume of transactions that do not involve a private equity acquisition will settle in at an approximate three to four times.

To apply this knowledge, let's reexamine the example from Chapter 1, where the company was generating $216,000 in annual cash flow. In a business of this size, the cash flow will be calculated by looking at all cash the company is generating for the benefit of the owner. We'll get into the details of this later. For now, just know that it's referred to as seller's discretionary earnings (SDE, or sometimes just "DE" for discretionary earnings).[20] This represents the total pretax cash flow benefit to the owner of the company. In other words, the total amount of cash that can be used for

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ongoing salary, debt service, reinvestment, etc.

Let's assume that this company can be acquired for 3.2 times the SDE, or $691,200. Let's also assume you'll have an additional $200,000 in inventory and working capital, as well as $50,000 in closing costs and legal fees. This bring the total cash need to $941,200.

You decide to maximize your ROI by reducing your capital infusion as much as possible. You work with an SBA lender to acquire the business with a 10 percent down payment, or $94,120 out of pocket.

When the total benefit is used to calculate the annual ROI to the buyer, it's a staggering 230 percent. The investor invests $94,000 and gets $216,000 as an annual return. Although it's important to understand that just like in real estate or private equity, you need to pay back the bank. In this example, about half your cash flow is now going to equity buildup in the form of monthly debt payments for the acquisition. It's a lot, but not bad considering a 90 percent leveraged asset.

Despite the debt payments, you're still getting just over $100,000 in annual cash flow to either take as salary or reinvest into the company, which translates on its own to an annual ROI of over 100 percent, since it's more than your initial down payment.

To put this in perspective, conservative, long term professional investors will attempt to beat the market's historical 8 percent annual ROI.[21] In real estate investing, the rent paid out to the owner in comparison to the purchase price of the building is called the capitalization rate, or "cap rate." Cap rates tend to fluctuate between 4 percent and 12 percent depending on the risk associated with the tenant and other variables. Forbes published an article stating that the average cap rate over a portfolio of real estate should level out to about 9 percent.[22] Here, the analogous cap rate would be 24 percent,[23] or comfortably more than double that of a comparable real estate investment.

Keep in mind that the total realized ROI for the investment will also include the sale of the company when you decide to exit, and not yet included

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in the calculated 230 percent annual ROI. We'll extrapolate this when we consider upside potential. For now, just understand that the total realized ROI for the investment should exceed the annual ROI.

This investment model wasn't invented by acquisition entrepreneurs. This is exactly the business model driving the entire private equity industry. Doesn't it make sense to apply it to entrepreneurship? Acquisition entrepreneurs simply borrow the business model of private equity rather than that of venture capital.

This is great when it works. However, taking on a lot of debt to buy anything is risky. If it goes wrong you could end up bankrupt, upside down on your investment, and divorced. Further, selling a privately held company is not quick and easy like a publicly traded stock. It's critical you understand the risks.

The ROI on small business ownership can be great, but just how risky is small business acquisition?

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MARGIN OF SAFETY

Risk is relative. The risk-return spectrum dictates that the more risk an investor takes the greater the return needs to be. Unfortunately, the "high risk, high return" model frequently plays out in the high-risk part winning out and producing lower returns.[24]

Warren Buffett, widely considered one of the most successful investors in the world, practices what's called *value investing*. The fundamental belief of value investing is that there is an intrinsic value to every company. This intrinsic value is not an exact number and is subjective in nature. In loose terms, it can be derived by calculating a liquidation value, then observing the additional value a company produces over and above that: competitive advantage, brand awareness, and present value of future cash flows, for example.

Buffet is notorious for investing only in offerings he understands, focusing on tangible assets and earnings, and buying when the price is favorable to its intrinsic value. The built-in assets, infrastructure, and earnings of the company in this case create a *margin of safety* for the investor.

Benjamin Graham and David Dodd, regarded as the inventors of value investing, coined the term *margin of safety* in 1934. It was so fundamental to Graham's thinking that he was quoted as saying, "Confronted with a challenge to distill the secret of sound investment into three words, we venture the motto, *margin of safety*."

This margin of safety refers to when an investor only purchases securities when the market price is significantly below its intrinsic value.[25] More recently, Warren Buffett and his partner, Charles Munger, made the concept popular by using it to attain extraordinary results.

By investing when the price is favorable to the intrinsic value, it effectively limits the downside risk, building in a level of protection into the investment.

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Managing the downside risk is one of the great fundamental practices of the world's most famous investors. It's similar to the old adage in real estate, "You make money when you buy, not when you sell." That framework is the anchor for real estate investors the world over.

Many will misunderstand what I just said. They will focus on paying only two-and-a-half times SDE instead of four times on a specific deal. Largely, the market will set the price of any individual investment; and although you shouldn't buy incorrectly, it's more my feeling that the small business private market already trades at its approximate intrinsic value. Perhaps this is because the market is fragmented, so potential buyers can't always find the right sellers. Or perhaps it's because private companies are illiquid and tough to trade if you wish to sell. More likely, the valuations have rightly settled in at a level in which a buyer can acquire them and make an appropriate return.

One way to illustrate the margin of safety in buying a small business compared to other forms of entrepreneurship is by considering how much is at risk and the odds that the company could completely fail.

As we've seen, the average startup launches with $65,000 in invested capital and has an approximate 90 percent chance of failure.

A venture-backed firm accepts an average of $41 million per startup and has an approximate 75 percent change of failure.

Now let's compare that to the acquisition entrepreneurship model.

Backing into an approximate by reviewing multiple sources, it seems that about 80 percent of small businesses transact for an amount below $1,000,000. Let's use the entire amount of the transaction ($1,000,000) rather than the invested down payment since this encompasses the total risk associated with the acquisition.

According to the Small Business Administration,[26] default rates of small business loans are currently right about 2 percent. Similarly, according to the Thompson Reuters/PayNet Small Business Delinquency Index (SBDI),[27] the amount of small business loans that go delinquent on the national level has

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been running under 1.5 percent since 2012.

This means the $1 million at risk when acquiring a business has about a 2 percent chance of failure. This is a drastically different profile than building from scratch. If you equate *not failing* with success, then buying a company has an approximate 98 percent success rate.

You could argue this is because small business valuations tend to be closer to their inherent value, rather than the somewhat irresponsible valuations of startups with no revenue, no infrastructure, and no earnings. They take a "what do you need to be a billion-dollar company" approach, rather than a valuation based on earnings.

From the point of view of an investor, you can see the asymmetrical risk tied to the different investments and see that there is a margin of safety built in to business acquisition, since the valuation formulas are based on very real past earnings.

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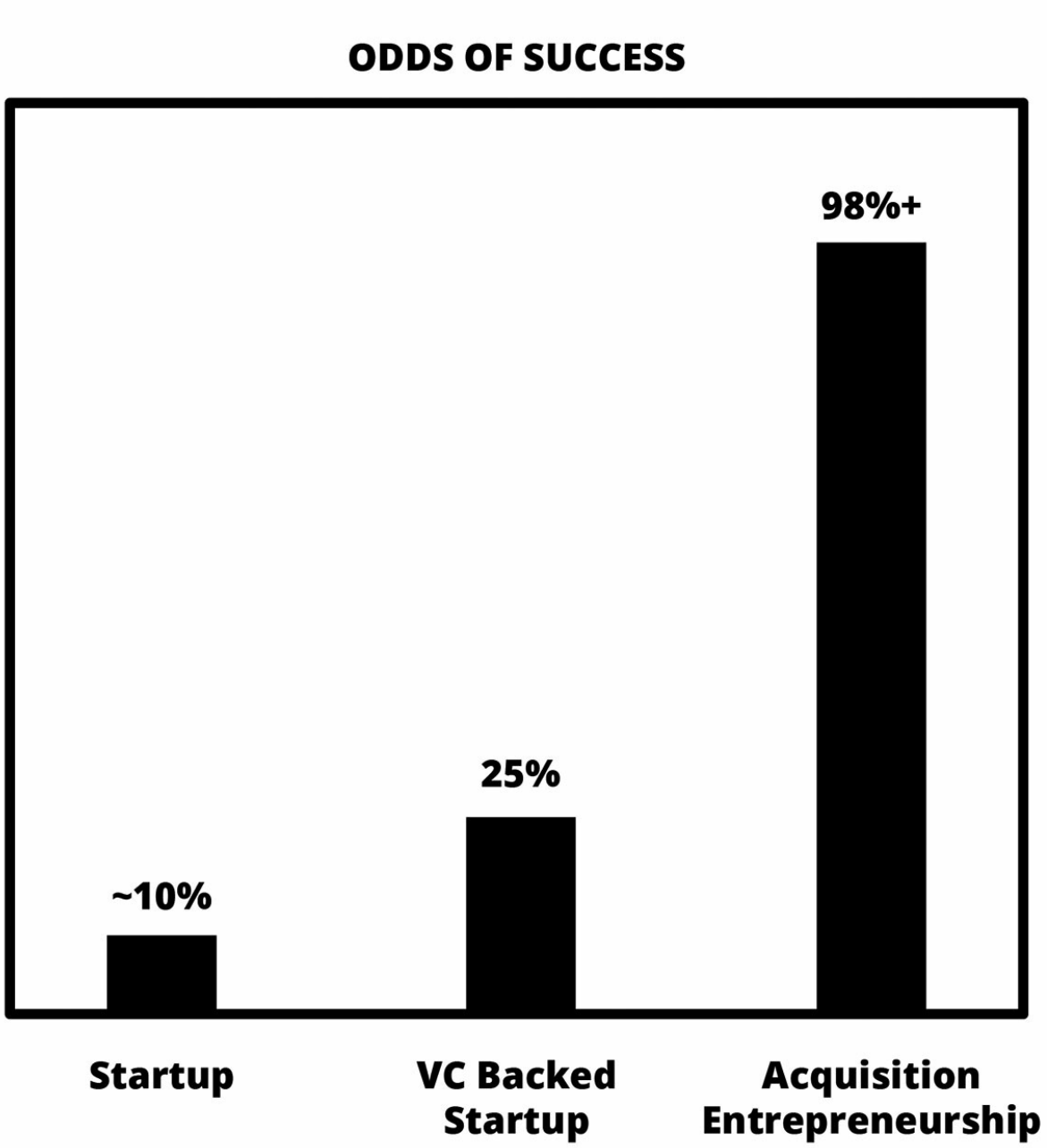

Figure 2.1: Odds of Success

A company selling at four times its earnings, for example, is conceptually providing a four-year payback to the investor. Conversely, the $41 million in VC money has a 25 percent chance of being paid back at all. There are people who have been very successful in either approach, but if it's engineering success into entrepreneurial efforts that we're after, buying before building might be just the tool we're after, since it eliminates so much of the

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unnecessary risk associated with entrepreneurship.

In addition, the cost of entry typically isn't much more than that of your average startup because of the debt vehicles you'll have access to. The debt is typically collateralized by the hard assets of the company. So, even though we're using $1,000,000 as the total outstanding risk amount in this illustration, in practice it will be significantly lower.

Like Graham, Dodd, Munger, and Buffet, acquisition entrepreneurs build in a margin of safety, simply by starting with acquiring profitable revenue first, then building from there.

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UPSIDE POTENTIAL

Having a margin of safety is critical for protection if the worst would happen, but that's not why we invest. We invest because of the upside potential available in an investment. We've illustrated how a positive ROI can be had in an acquisition, but the upside potential for an acquisition entrepreneur surpasses most investments by a long shot.

Earlier in the chapter, we discussed both cash flow and appreciation as the primary vehicles of driving return on an investment. We bought an asset for $100 and sold it for $120 seven years later. Over the course of the twenty years following 1996, the median residential home sale price appreciated at a rate of 3.1 percent annual compounded rate.[28] Not bad.

However, because acquisition entrepreneurs are active in their business, they can use their time, commitment, and skillset to grow revenue and increase earnings. This is where entrepreneurs have the advantage over all other investment classes and are really able to hit the acceleration pedal. If you were attempting to increase your appreciated value in real estate, for example, there's not much you can do. The market moves, and the value of the homes move with it. It's not even called "appreciation" in business, it's just called building value. And after you buy, you are going to build.

Perhaps your most critical initiative as an acquisition entrepreneur will be to grow your business. In the four years following March 2013, revenue reported by ultra-small businesses (those generating under $1 million in revenue) increased 20 percent.[29] Revenue is one of the key drivers of business value, and the same report signals a 13.5 percent increase in transaction price over the same time period.

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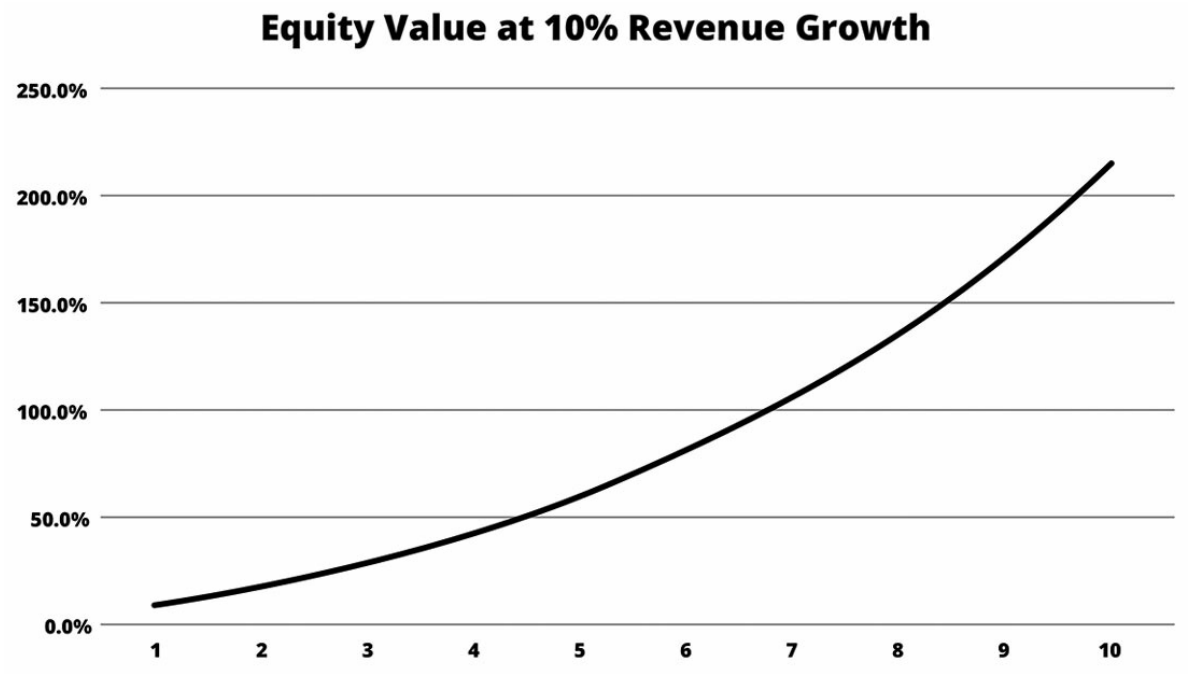

Business can and grow at 10 percent or more in revenue per year over the prior year. A business with an aggressive growth rate reaps tremendous value increase. If a 10 percent growth rate is achievable in your business, then it will be twice the size it is today in just seven years. The cash flow increases and the value of your asset increases, providing a vehicle for building wealth.

Now you're doing something you love, paying yourself, building your team, growing your business, building equity through your debt payments, and reinvesting when needed. Heck, you might even choose to accelerate the growth of your company through additional acquisitions and fund them entirely through the cash flow of your business.

Your business has one thing that no other investment has. You. And *you* are a value creator. Do not wait. Get to work immediately building value.

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AN ILLUSTRATION

Let's look at an example scenario so we can walk through what this looks like in practice. It's grossly full of assumptions, but they'll help sketch a blueprint of how it all works, allowing you to see how building value in your business might look.

Let's return to our hypothetical $216,000 in SDE company. You've bought the company for 3.2 times SDE, or $691,200. Then the working capital and inventory added $200,000, and closing costs and lawyer fees were another $50,000. This made the total transaction $941,200.

You put 10 percent down, or $94,120, and took the balance of $847,080 out as an SBA loan at a 6 percent interest rate.[30]

You pay $9,400 in loan payments every month from the $18,000 in available cash flow from the business.[31] This leaves $8,600 in available cash flow to pay yourself and any additional management, or to reinvest into marketing or product development.

You decide you can grow the sales of the business at 10 percent every year during that ten years.

We said this business was generating $1.4 million in annual revenue at the time of purchase. Growing at 10 percent every year, you exceed $2 million in year four and $3 million in year eight. By year ten, your company is generating $3.6 million in annual revenue. Assuming SDE maintains at 15 percent of revenue, the company is now generating $540,000 per year in owner benefit.

And guess what? Your bank loan is paid off, so the $9,400 per month that was going to them is now coming to you. In addition, you've built up the equity in the company. If you did choose to exit the business, the bank is no longer owed any money.

Because you grew the company at a healthy 10 percent every year, you get

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a higher multiple of SDE when you sell. In year eleven, you agree to exit at a price of four times SDE, which equals $2.2 million. You sell the inventory and working capital to the buyer in addition to the purchase price, so you get an estimated additional $2.5 million at exit.

Not bad for a $94,000 investment. The exit of $2.5 million represents a 35 percent compounded annual interest rate on your original investment. But don't forget you had the benefit of the cash flow and equity build up from the SDE the entire time. Your total pretax compensation from the original $94,000 investment, less the debt payments, is $5,747,934. This represents an astronomical 45 percent compounded annual growth rate.

Just for comparison, the same $94,000 in value invested in real estate would have appreciated to $132,000 in that same eleven years.[32] A balanced stock portfolio generating 8 percent would have increased to $219,000.

Investment	Year	Revenue	SDE	Exit
$94,120	0	$1,400,000	$210,000	
	1	$1,540,000	$231,000	
	2	$1,694,000	$254,100	
	3	$1,863,400	$279,510	
	4	$2,049,740	$307,461	
	5	$2,254,714	$338,207	
	6	$2,480,185	$372,028	
	7	$2,728,203	$409,230	
	8	$3,001,024	$450,154	

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	9	$3,301,127	$495,169	
	10	$3,625,000	$543,750	
	11	$3,987,500	$598,125	$2,500,000
Total Return (less debt payments)				**$5,747,934**

Figure 2.2: Sample Projection

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A FASTER ROUTE TO VALUE CREATION

Acquisition entrepreneurship is an active, rather than passive, approach to investing. By aligning your work with your asset, you're able to take wealth building into your own hands and build something worth working for.

It takes a lot of hard work and long hours, but with acquisition comes ownership of something with inherent value from the beginning and puts you in the driver seat for increasing that value. The acquisition entrepreneur is immediately an investor in her company and in herself. With the future under her control, the potential value delivered to the world and the financial upside can be accelerated and significant.

Traditional startups focus entirely on the "appreciation" lever—attempting to create something out of nothing—while starting with acquisition has the same outcome as most successful startups but provides a very bankable asset with a margin of safety and a promising ROI model.

This book builds a roadmap based on the principles that drive a small business transaction from under $1 million up to about $20 million and beyond. That may seem like a big range, but the rules in this segment are all handled essentially the same.

One thing that the venture capital firms are getting wrong is that 99.9 percent of all exits occur with companies under $30 million in revenue—and the trend is increasing. The demand for buying this size firm is approaching insatiable—especially in the technology industry. In Basil Peters' book, *Early Exits: Exit Strategies for Entrepreneurs and Angel Investors (But Maybe Not Venture Capitalists)*, he boasts the demand and benefits of smaller exits. Peters highlights that smaller exits between $15 and $30 million are too small for the press to pick up and an excellent way for the entrepreneur and angel investor to make several million dollars at exit.

Larger companies don't innovate from scratch anymore; they are just too big. Google, for example, did not even invent Adsense—their enormous pay

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per click management platform—they acquired Adscape for $23 million and built it out from there.

Smaller exits, defined as those under $30 million, are where all the action is and exactly where you won't find VCs. More and more private equity firms have figured this out, but in companies with less than $2 million in earnings, even they begin to be noticeably absent. Smaller exits and smaller acquisitions are the realm of the acquisition entrepreneur—and exactly the area where they can make millions.

All that said, let me be clear that although entrepreneurs have a wonderful vehicle for engineering long-term wealth in their companies, they are almost never driven by wealth creation. Entrepreneurs have non-financial benefits that drive them. We relish in the autonomy, problem solving, growth, and passion we have for our companies. These aspects are not lacking in the acquisition model. For a true entrepreneur, financial independence has been reached the moment they take ownership of a company or an idea, from the very beginning, because there is no separation between work and life. It is the same mission and the same time. This is because for an entrepreneur, working hard for something they care deeply about is the life worth living. It's fun, and these benefits are attainable on day one. Perhaps this is the "real" wealth we all want—the purpose that comes along with creating value in your life.

So who are these entrepreneurs? What does it take to succeed? What drives them? And how can we know whether we are built from that cloth? These are the questions we address in the next chapter.

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PART 2
EVALUATION

"Set your mind on a definite goal and observe how quickly the world stands aside to let you pass."

—Napoleon Hill

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