THE KICKASS ENTREPRENEUR'S GUIDE TO INVESTING

THREE SIMPLE STEPS TO BUILD MASSIVE WEALTH WITH YOUR BUSINESS'S PROFITS

JEFF WIENER

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by

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Wiener, Jeffrey Sean, 1968 –

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Issued also in electronic format.

ISBN 978-1-7753600-0-1

1 Entrepreneurship, Finance I. Title

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To my amazing wife, Heather, thank you for joining me on life's journey.
To my kids, Jordan and Jessica, thank you for making life so much more fulfilling.
To Dad for teaching me the value of work, and Mom for always being there and for being amazing.

To my Peerscale mates, friends, clients and staff—without you this book would not have been possible.

As a budding entrepreneur, have you found that your investment portfolio's getting its ass kicked? If so, it's time to take charge, shift your wealth into high gear, and start building the ultimate kickass entrepreneur's investment portfolio.

Learn a simple-to-follow, three-step, time-tested asset allocation strategy that allows you to participate in your portfolio's growth, build wealth, and achieve kickass compounded returns. It's time to **stop listening to your advisor, start focusing on building your portfolio**, and take control of your financial independence and future.

IMPORTANT NOTE TO FINANCIAL ADVISORS AND ACCOUNTANTS WORKING FOR ENTREPRENEURS:

If you're not including the entrepreneurs' businesses as part of their overall equity and risk in their asset allocation model, nor leaving them with cash or liquidity in their portfolio, then you're **unknowingly misleading** your clients and **doing them a disservice.**

If you want to help your clients, then you need to start thinking like an entrepreneur.

An Excel document will

be refered to throughout

the book starting in Chapter 3.

Please download the file from

the website:

TheKickassEntrepreneur.com/Excel

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Introduction

There was a time when I would never have imagined that I would end up where I am today, semi-retired at age 49, financially free, and living the life I have always dreamed of. In fact, back in March of 1992, I was in a much different position, cash-strapped, running a barely profitable company, and $500 away from closing its doors. As I helplessly watched my finances drop closer to entering the red every day, I knew I was doing something wrong, not only with the business itself, but with how I was trying to invest profits and grow my wealth.

It all started in the fall of 1991. I opened the door on the first day of my new telecom business and said to myself, “Okay, let the phones ring.”

If only it were so easy.

I spent several months beating the pavement all over downtown Toronto trying to land clients. I visited the reception desk of every major office tower in an attempt to meet with the CEOs of each business in each building—instead, I was constantly dragged out by security.

It was the same story every day: I would walk into a building looking for a new client, any client. Every time, security not-so-gently encouraged me to leave. That cycle went on for months. Like any good entrepreneur who believes in his business, I was putting in the work. But it wasn’t working.

As I watched my friends from college climb the corporate ladder, I often wondered whether I had made the right decision to open a business instead of getting a typical day job. I feared that the risk of becoming an entrepreneur wasn’t going to pay off, and just in case it didn’t, I began preparing my MBA applications.

The first thing a new business does today is create a website and build a social media presence to establish online credibility. When I started my business in 1991, however, the internet wasn't an option. So, I went with what was available to a cash-strapped entrepreneur at the time: free press.

I approached local and national newspapers and radio stations, pitching myself as a young, recent college graduate who had started a business that brought new voicemail technology to Canada. It seemed like a good angle, and I hoped for the best.

And what do you know; it worked.

Within just one month, I was in at least five national newspapers and on radio stations, and many more local magazines and newspapers.

The phones started ringing.

For the first time, I didn't have to wonder if I had made a big mistake in starting my own business. I went from a few phone calls a week to ten to fifteen qualified leads a day, all inside of thirty days. There were so many calls coming in I had to hire a part-time receptionist just to field them.

The phones continued ringing and I started making sales. I still remember the first big one, a deal worth more than $15,000, which was huge at the time. It was crucial; a few more days and I would have been completely out of cash.

Between my non-stop sales efforts and newspaper articles, the business grew and I closed the books on my first year as an entrepreneur with $150,000 in revenue.

By 1994, three years after starting the business, we made $70,000 in profits, and by 1999 we were making close to $220,000 per year in profit. Throughout those years, I invested those profits in the stock market.

Things were looking good: my business was doing well, the stock market was doing well, and I felt like I was on a roll. Then came the dot-com crash of 1999, in which I lost more than 60% of my investments.

Until that point I never thought I needed an investment advisor. I just invested in the stock market and expected it to continue rising. And it did, until it didn't.

Around that time, I had recently started a software company in the dot-com sector, and I needed access to capital to expand the business. With my investment portfolio badly damaged, I decided to tap the venture capital markets. Unfortunately, I quickly found that not only were other investors now spooked by dot-com firms, many were also hurt by the stock market correction, so access to cash was quite limited.

At that point I didn't want to invest my depleted cash reserves back into the dot-com firm, so I reluctantly closed the software division and chose to refocus on the telecom company.

The telecom business continued to expand and profits were healthy, so for the next few years I concentrated on building it. I also decided that going forward I wasn't going to invest the profits myself; this time around, I needed help.

I spoke with countless investment advisors and I searched the internet for investment philosophies specific to entrepreneurs, but I didn't find anything other than the traditional investment advice (stock, bond split), which I wasn't contented with. I decided that I wasn't going to get caught again in a stock market correction with no access to cash, so for the next eight years, I invested cash very conservatively in secure money market, GICs, T-Bills, and Certificate of Deposits (CDs).

Then 2008 happened: Ka-Boom! Faced with the biggest financial disaster in decades, the capital markets closed down.

I, however, had lots of dry powder (cash) ready to go shopping. At the same time, I finally came across an investment strategy that I felt made sense for me, my business, and other entrepreneurs—a

2,000-year-old “bucket strategy,” the same one that lies at the center of this book. Despite the financial crisis, over the next ten years my investments were able to produce a 25% year-over-year compounded return.

In late 2017 I sold to private equity a significant share of the telecom company I started in 1991, and I decided that I was going to devote the next many years to helping other entrepreneurs build their businesses and wealth, using the same strategies that have been integral to my success and have propelled my wealth to a 30% compounded year-over-year growth rate over the past twenty-seven years.

Here’s how.

Investing as an Entrepreneur

As a small-business owner, you may be at a stage where you’ve successfully grown your company and have achieved a level of profitability, but are stuck wondering how to invest your profits. Or, you may still be growing your business and are looking for investment strategies specific to entrepreneurs to help you in that process. No matter what stage, if you’re an entreprenuer, you’re likely always looking for strategies on how to create and build wealth—and if you’re not, you should be.

To do so, perhaps you’ve spoken with an investment advisor—or a few for that matter—and are getting the sense that they just don’t understand how entrepreneurs think or how their needs differ from those of other investors. (Worse yet, many advisors are compensated by investing and trading your cash in order to justify their high fees.)

Most financial advisors will look at the amount of cash you have available to invest, check the optimal investment strategy and investment horizon for someone your age, come up with a percentage of stocks and bonds based on your available cash, and then design a supposedly “perfect” asset allocation model for you. There’s just one problem: that conventional asset allocation model doesn't work for entrepreneurs.

Your investment and cash requirements are different from the regular investor's, as you already have a large percentage of your wealth tied up in your business, which is equity. A downturn in the market will result in a downturn not only in your stock portfolio, but if the economy enters a recession, there's a good chance your business will be in need of extra cash. Most financial advisors simply don't understand that. They also fail to take an appropriate approach to asset allocation.

Entrepreneurs must understand how to make risk-appropriate decisions when it comes to both investing and their businesses overall. As a business owner, when you invest in yourself and your business you take control of the outcome. You also maintain control by finding your own opportunities and capitalizing on them. With careful diligence, planning, research, and education, you can influence the outcome of your investments without having to rely on the stock market.

In this short, ninety-minute read, I'm going to show you the simple-to-follow, time-tested "bucket strategy" that will allow you to participate in your portfolio's growth and achieve kickass compounded returns, like those I have experienced over the past twenty-seven years.

This strategy is not only simple, but when measured against many complex portfolio diversification models, the optimized bucket strategy performed at the same level, or even better.

It doesn't require a PhD or deep understanding of the markets to follow, plus, it will allow you to focus on building your wealth. Still, this isn't a magic pill or a get-rich-quick scheme; it takes patience, hard work, and passion for building a business to make the strategy work. But let me tell you something: it's worth it.

After reading this book, you can tell your investment advisors that you're in control now, and you'll let them know how to invest your profits in the future. In fact, since this book is a quick read, and it's free, feel free to send them to my website, TheKickAssEntrepreneur.com. Once they're done, they'll understand you, the entrepreneur, just a bit better.

It's time to stop watching the markets, start focusing on building your wealth, and take control of your financial independence.

> NOTE: An Excel document will be referred to throughout the book, starting in chapter 3. Please download the file from TheKickassEntrepreneur.com/Excel and keep it handy as you read.

CHAPTER 1

The Three-Buckets Strategy

Over the years, I've had the opportunity to meet some incredible entrepreneurs who are business-savvy, willing to take risks, and able to develop successful services, products, and companies. Some of those very same entrepreneurs, however, don't know squat when it comes to investing the profits they've made through all their hard work. Take, for example, a good friend of mine whom we'll call "John Anderson" (not his real name).

John Anderson built a successful appliance retail operation from a one-man shop to an eight-store, fifty-employee, $8 million business in just fifteen years. Unfortunately, John was so busy building his empire he spent little time contemplating how he should invest his profits, which in 2006 alone amounted to $800,000 before taxes. John was always of the opinion that his best investment was his own business, so he spent every possible minute managing and building it. He invested his accumulated $3 million into a holding company with the bulk of his assets sitting in a conventional 70% stocks, 30% bond allocation. John maintained that percentage allocation for years.

Then, the 2007 recession and financial crisis hit, and John's revenues declined from $8 million to $5 million within one year. His $2.1 million stock portfolio also suffered a dramatic fall of 40%, leaving him with just over $1.25 million in stocks and $900,000 in bond funds.

The once profitable business now faced a $300,000 shortfall and

John realized he needed to sell some of his portfolio to cover those losses (little did he know that he would also experience a loss of $150,000 in the subsequent year). Luckily, John still had some investments, and his business would later turn around.

While John had thought he was properly diversified with a 70% stock, 30% bond allocation, he was, in fact, much more exposed to the equity markets than he had ever considered. He was fortunate enough to have a somewhat liquid portfolio that, although not ideal, could be liquidated for cash. Otherwise, his business could have gone under.

During the 2007–2008 financial crisis, many business owners were heavily invested in non-liquid auction rate securities and couldn't get access to their cash, or worse, used a margin account to raise cash for personal expenses, preferring to borrow at the low rates offered while leaving their investment account intact. A margin call isn't ideal in any scenario, let alone in 2008 when most companies' leaders were already stressed from the market downturn and needed to focus on rebuilding their business.

I have spoken with enough entrepreneurs and other business owners to know that they regularly encounter two main problems when it comes to profits:

- Owners spend too much during the good times buying high price-tag items such as cars, boats, and homes, and don't save for their future.
- They have a poor sense of how to invest in the markets and make bad decisions that can leave them exposed when the markets turn.

John Anderson is your typical entrepreneur; he has a risk-oriented personality and likes to invest in more-aggressive ideas. Unfortunately, in his case, he didn't have a good sense of what he was doing. Instead, he was always game to try the "next big thing" as recommended by a friend or his brother-in-law financial advisor. Instead, what he needed was an easy-to-stick-to investment strategy and an asset allocation approach tailored to entrepreneurs.

Understanding Asset Allocation

One of the best books I ever read on money and portfolio management was written by Anthony Robbins, one of the top life and business strategists, and it is quite appropriately named *Money: Master the Game.*

In the book, Robbins provides what he calls his “All Weather Portfolio,” an optimal asset allocation based on years of back-testing provided by one of the smartest investors in the world, Ray Dalio. Dalio is a billionaire hedge fund manager, one of the top 100 wealthiest investors, and in 2012 appeared in *Time Magazine’s* list of the 100 most influential people in the world.

The optimal All Weather Portfolio consists of the following:

40% Long-Term US Bonds
30% Stocks
15% Intermediate US Bonds
7.5% Commodities
7.5% Gold

Although I admire Robbins, and certainly respect Dalio’s investment advice, this allocation might be suitable for the typical investor, but not for entrepreneurs like my buddy John.

The All Weather Portfolio was designed for the traditional non-entrepreneur investor who doesn’t own a business. That investor is counting on the CEOs from Google, Apple, GM, and all of the other publicly traded companies to produce the returns for them. You, on the other hand, don’t need Apple to create your wealth.

Dalio suggests that the ultimate All Weather Portfolio has a 30% stock allocation. As an entrepreneur, you likely already have much more than 30% of your overall wealth allocated in equity—your business—which is, you hope, making a healthy profit.

In John’s case, his business was his biggest asset, but he wasn’t very well diversified. Using a conventional 5 X EBITDA valuation, at its peak John’s business was worth $4 million ($800,000 X 5), and his total net worth was $7 million ($4 million in business and $3 million in cash). He had almost 60% of his net worth tied up in his business, and more than 85% in equities ($4 million for his business, and $2.1 million in stocks). Since the $2.1 million was invested in US stocks, his business was heavily invested in the US economy, which is great when the economy and market are doing well, but as mentioned, when the markets turn, he’s left quite vulnerable.

NOTE on EBITDA: The acronym EBITDA stands for “Earnings before Interest, Taxes, Depreciation, and Amortization.” It is essentially your net income (bottom line) with taxes, depreciation, and amortization added back in. This, in effect, normalizes your income and allows for comparisons of profitability among different companies, both in and outside of your sector. EBITDA and how to calculate your business’s value in greater detail are discussed further in chapter 4.

In an ideal scenario, however, John would have been invested to take advantage of the downturn in the markets. Ideally, he would have had access to his full $3 million during the recession and would have been in a position to pounce on any opportunities that might have arisen during such a market downturn (and let me tell you something, they always do).

John should have developed a portfolio of assets with low or negative correlations to ensure both stability and the ability to take advantage of fluctuating markets, one of the first tenets of proper asset diversification.

What is Proper Asset Diversification?

Harry Markowitz introduced the concept of modern portfolio theory (MPT) in a 1952 essay, for which he was awarded a Nobel Prize in economics.

MPT assumes that given two portfolios that offer the same expected return, an investor will choose the portfolio that is less risky. Similarly, an investor who takes larger risks will expect larger returns, and by that measure will not invest in a larger-risk portfolio if it doesn't offer the potential for larger returns.

MPT suggests that investors can reduce their risk by holding a portfolio of assets that are not perfectly positively correlated. By diversifying assets inside a portfolio, it is possible to lower the overall risk. For example, negative correlations are used to minimize, or mitigate risk inside a portfolio, such that when one asset increases the other decreases. Using some negatively correlated assets inside a portfolio helps reduce the overall volatility of the portfolio.

In 1998, Roger Gibson, chief investment advisor of Gibson Capital and known for his approach to modern asset allocation, published a leading paper titled "Asset Allocation and The Rewards of Multiple-Asset-Class Investing." Gibson demonstrated how combining four asset classes with potentially divergent returns can produce a portfolio with a higher return and less volatility than a weighted average of the four asset classes:

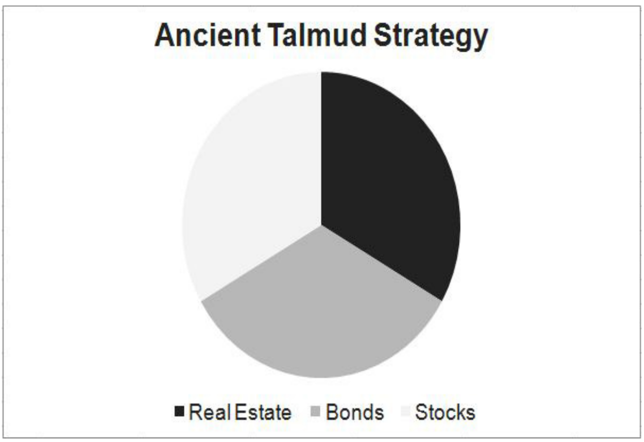
> "For investors concerned primarily with maximizing portfolio returns, we see that multiple-asset-class strategies have dominated single-asset-class strategies. For investors who are more concerned about minimizing volatility, again multiple-asset-class strategies are superior. The Sharpe Ratios provide a risk-adjusted performance measurement for each portfolio. Again, we find multiple-asset-class strategies delivering much higher rates of risk-adjusted returns than single-asset-class strategies."

Gibson goes on to write, "As we move toward broader diversification, rates of return increase, volatility levels decrease, and Sharpe Ratios improve.

> The Sharpe Ratio is the average return earned in excess of the rate of volatility or risk. Generally, the greater the value of the Sharpe Ratio, the more attractive the risk-adjusted return.

Of course, neither Gibson nor Markowitz was the first to come up with the concept of asset allocation. In fact, Gibson's paper begins with the following quote from the Talmud, a biblical scripture that's more than 2,000 years old:

"Let every man divide his money into three parts, and invest a third in land, a third in business, and a third let him keep in reserve." See Figure 1.1.



It seems that the scholars of that time already understood the concept of portfolio diversification.

Such a strategy is known as a "bucket strategy," because we are allocating assets into different buckets.

If you were to apply the Talmud Bucket Strategy today, it could be implemented by placing 1/3 of your assets in real estate ("land"), 1/3 in stocks ("business"), and 1/3 in bonds ("reserve"), as is shown in the figure.

Gibson applied that allocation to the the bear market of 2000–2002, in which the large company US stocks lost 47%, while the real estate market gained 34%, and US Bonds gained 29%. See Figure 1.2.

Bear Market Performance (March 24, 2000 - October 9, 2002)		
Asset Class	Total Return	
US Bonds	29%	
US Stocks (Large Company)	-47%	
Real Estate Securities (REITs)	34%	
		Figure 1.2

With a portfolio of 2/3 US stocks and 1/3 US bonds, the portfolio returned -22%, but when 1/3 of stocks was moved to real estate, and the portfolio returned positive 5% over the two-year period.

Meb Faber did a further review of the 2,000-year-old Talmud investment strategy, only this time taking into account the 2008 recession, and found that it performed equally as well as twelve other much more complicated portfolio strategies over a forty-year period, from 1973 to 2012. If you look at the column at the farthest right in the following figure 1.3, you will notice the Talmud column features a compound annual growth rate (CAGR) of 9.69% and a Sharpe ratio similar to most of the other strategies.

Stats 1973-2012	60/40	PERM	IVY	Risk P	Swensen	El-Erian	Arnott	Tobias	Bernstein	Seven 12	All Market	All Mkt Lite	Talmud
CAGR	9.48%	8.88%	9.92%	9.48%	9.70%	10.39%	10.13%	9.54%	10.49%	10.47%	10.14%	9.44%	9.69%
TBill CAGR	5.41%	5.41%	5.41%	5.41%	5.41%	5.41%	5.41%	5.41%	5.41%	5.41%	5.41%	5.41%	5.41%
Stdev	10.28%	7.29%	10.28%	6.48%	10.56%	10.39%	7.98%	10.58%	12.65%	9.59%	8.52%	8.75%	10.65%
Sharpe	0.40	0.48	0.44	0.63	0.41	0.48	0.59	0.39	0.40	0.53	0.56	0.46	0.40
Stdev (Down)	6.70%	4.35%	8.73%	4.46%	8.19%	8.40%	6.46%	7.50%	9.30%	7.67%	6.19%	5.96%	7.99%
Sortino	0.61	0.80	0.52	0.91	0.52	0.59	0.73	0.55	0.55	0.66	0.76	0.68	0.54
MaxDD	-29.28%	-12.74%	-46.00%	-14.41%	-41.07%	-43.40%	-32.50%	-35.73%	-42.26%	-40.29%	-29.11%	-27.20%	-38.01%
% Positive Months	62.92%	64.79%	67.08%	69.17%	66.46%	66.88%	69.79%	63.75%	63.75%	66.88%	67.92%	67.50%	64.17%
$100 becomes	3,772.64	3,023.76	4,433.45	3,774.35	4,087.41	5,251.40	4,785.59	3,857.93	5,449.87	5,412.42	4,804.89	3,718.63	4,069.36
Inflation CAGR	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%

Figure 1.3

Source: MebFaber.com. Reprinted with permission. http://mebfaber.com/2013/09/26/how-does-a-2000-year-old-asset-allocation-strateg-y-perform/

What is so appealing about this strategy, aside from its simplicity and strength, is that it can easily be tailored to today’s entrepreneurs looking to invest their wealth and grow their business. Entrepreneurs need to value their businesses as part of their equity exposure, and include that in their overall portfolio strategy; the three-buckets strategy lends itself to just that.

The Kickass Three-Buckets Strategy

The three-buckets asset allocation strategy for kickass entrepreneurs is based on the Talmud strategy, only in this case, since you already have a high concentration of your wealth in your business, you should be moving your business profits into both real estate and reserve (bonds and other fixed-income instruments). Government bonds, as you will discover in the coming chapters, are negatively correlated to the US stock market, so they provide a decent hedge against an economic downturn. Plus, if you purchase bond ETFs, you will be fairly liquid if and when you need access to cash.

The Talmud Asset Allocation Strategy suggests that you keep a third of your assets in reserve. Both Gibson and Faber interpreted the “reserve” component of the allocation as bonds. In the three-buckets strategy for entrepreneurs, “reserve” can also be interpreted as cash or other fixed-income secure investments. The underlying idea is that the reserve component of your portfolio is in a stable, fairly liquid fixed-income portfolio, including the money market, GICs, T-Bills, or bond ETFs, all addressed in greater detail in chapter 5.

Such a properly diversified portfolio will help you avoid the type of issues that faced many investors during the 2007–2008 market downturn and will also give you a competitive advantage when opportunities arise. As you can see so far, this investment strategy isn’t overly complicated and is simple enough for any entrepreneur, even those with little understanding of the investment market, to take charge of their financial future.

Throughout the remaining chapters, I’ll show you the specifics and get you on your way to building massive wealth. But first, let’s take a look at the mindset you have to adopt to become a true kickass entrepreneur.

Chapter Summary at a Glance:

- Many business owners have two problems when it comes to profits:
    - Owners spend too much during the good times buying high price-tag items such as cars, boats, and homes, and don’t save for their future.
    - They have a poor sense of how to invest in the markets and make bad decisions that can leave them exposed when the markets turn.

- If your business and the US economy are too closely related, they will follow the same direction, whether for better or for worse.

- The ideal scenario in proper asset diversification is to own a portfolio of assets with low or negative correlations.

- Investor can reduce their risk by holding a portfolio of assets that are not perfectly positively correlated. By diversifying assets inside a portfolio, it is possible to lower the overall risk.

- The Talmud’s asset allocation advice of dividing investments into three parts—land, business, and reserve—can still be applied today, especially for contemporary entrepreneurs looking to build and grow their wealth.

CHAPTER 2

The Kickass Entrepreneur Mentality

Six weeks before I was about to close on the largest financial transaction of my life, the bank changed its mind on the loan it had agreed to give me. The loan officer called me on September 15h, 2008, the day Lehman Brothers filed for Chapter 11 bankruptcy protection.

"Sorry Jeff, we know that we signed the paperwork to advance you the funds for the mortgage on your apartment building, but unfortunately we can't move forward as planned."

Now that was a nerve-racking experience.

Let's rewind.

It was the summer of 2008, and I had decided that I was ready to expand my investment portfolio into real estate. More specifically, I wanted to purchase my first apartment building. My timing couldn't have been worse, or better, depending on which way you want to view the situation.

OK, let's rewind even further: I was exposed to the apartment building business as a young child. I vividly remember visiting the small apartment buildings my grandfather owned in the early to mid-1970s. He was a European immigrant who arrived in North America in the early 1950s with a suitcase, a wife and two children, and a few dollars in his pocket. He didn't speak English when he got here, which made the transition all the more difficult.

Luckily, he found a job as a butcher, but it wasn't an easy life. Still, he saved every penny he could and ended up putting that money into apartment buildings. Real estate became his salvation from the countless hours he spent chopping meat, taking orders, and waiting on customers in the butcher shop. Although I didn't understand it at the time, I later grew to appreciate what it meant to own an income-producing real estate property.

My grandfather, who came from a different generation of course, refused to hire out any of the work that needed to be done to his properties. Every time we visited his buildings, which I always enjoyed because it meant spending time with him, he would pull out his paintbrush and do a minor touch-up, replace the lightbulbs or lay down new tiling, weed the garden or fix the toilet, and let's not forget collect the rent. The thing is, my grandfather wasn't a handyman; he was a butcher with a paintbrush. Nothing ever looked perfect, but he took tremendous pride in his buildings and the small real estate portfolio he had created.

When we were together, he explained as best he could in a non-business way—his heavy European accent not making it any easier—concepts such as mortgage, income, and the building of wealth through real estate investment. Three things made his eyes twinkle: one, speaking of my grandmother, his princess; two, his family; and three, his buildings. He was my inspiration, and with that experience in mind, I knew that someday I, too, would get into the real estate market.

When I starteted out, it took me a few months, but I eventually found the perfect property: a 21- unit building built in the 1930s on a beautiful street close to downtown Toronto, in a trendy, upscale part of the city known as The Beaches. It was an otherwise older, ugly building, but it was in good condition and you couldn't beat the location.

The building had tremendous upside. The capitalization rate, or CAP rate (net operating income divided by the current market value) was excellent at 8.5%, the rents were well below market, and the building looked like a great investment opportunity. The sale price was $1.65 million. Although I realized it would require a lot of work—including a new roof, boiler, driveway, and a list of engineering projects that I needed to complete before the bank would finance me—I was ready.

I put down my nonrefundable $100,000 deposit in June of 2008 and was ready to close. What I didn't know was that a complete market meltdown was mere months away. By October, post-Lehman Brothers, the credit markets came to a complete freeze.

Then on September 15, the bank pulled the loan. Forgetting a day like that is hard; actually, it's impossible.

In my wildest imagination, it never occurred to me that this could happen, especially since I had the signed paperwork and a commitment from the bank. Talk about stressful. I didn't sleep for days, and I had this nagging feeling that I was screwed.

At such a late stage, I had a few options, one of which was walking away from my $100,000 deposit—not an ideal scenario. The other was to find an alternate bank.

I made calls and as it happened, none of the banks was interested in lending at the time. Furthermore, it was going to take too long to coordinate a new bank loan in that short a period, especially considering the state of the credit markets.

I called my lawyer, and we sent a legal letter to the original bank. After a great deal of back and forth, the bank agreed to the loan, but changed the terms to an incredibly unfavorable rate. It felt like extortion.

I called the seller, explained that I was in a bad predicament, and told them I was ready to walk away from the sale. Although I understood I would likely lose my deposit, buying the building in that environment and with the new interest rate just didn't feel like a risk I was prepared to take.

Uncertain of what to do, I asked the seller to take an additional $50,000 off the price, which somewhat to my surprise they agreed to. And just like that, I was the new owner.

I closed on the building on November 18, 2008. The headline in the papers that day read: "US Has Spent Over $4 Trillion to Combat Economic Crisis." At the time I honestly wasn't sure if I had made the right decision. I had a large mortgage, approximately 60% of the building's value, and it felt like the world economy was dropping down to zero.

I tried to stay positive and kept repeating one of Warren Buffett's famous quotes to myself: "Be fearful when others are greedy, and be greedy when others are fearful." It almost became my mantra.

Although the real estate market was essentially frozen, I decided to build a portfolio as quickly as I could. I took all of my 2009 business profits and bought my second building that year, this time a high-end five-unit property with a 7% CAP rate. In 2010, I bought my third building—an 11-unit at a 6.5% CAP rate—and in 2011, I capitalized on the poor state of the real estate market in South Florida and purchased a 12-unit residence in north Miami Beach at an 8% CAP rate.

Fast forward a few years, and in 2016 I sold the Miami building at double what I paid. When I bought it in 2011, it cost me $1 million. I put down 50% and by 2016 the building was worth $2 million. In that five-year span I paid off $100,000 of the mortgage, and when the building was sold, I turned my initial $500,000 investment into a $1.6 million value: a 220% return in five years. My grandfather would be proud!

Today, the buildings are all worth almost triple what I paid for them and CAP rates for multi-unit residential buildings (MURs) are trading at historical lows of 3%. Most of my mortgages have also been paid for. I'm now sitting on large income-generating assets that continue to provide large inflation-protected dividends.

Getting into the Right Mindset

As you've likely picked up on, I love real estate! It's my favorite of the three buckets, it's an amazing vehicle for creating wealth, and

I give the topic plenty of attention throughout this book. But, I also wanted to relay the above story to help you understand the mindset necessary to succeed with your investment portfolio; it's the same one that makes you a kickass entrepreneur.

First, take a take a page from Warren Buffett and don't get fear and greed mixed up at the wrong times. Remember, "Be fearful when others are greedy, and greedy when others are fearful."

Related, plow through your fear, and when you find the right opportunity, make sure to pounce on it. For example, if I hadn't taken a risk on that first building, I may never have entered the real estate market at all; I could still be pounding the pavement of downtown Toronto for all I know!

Make sure you educate yourself and then trust your instincts. If you're lucky enough to have a grandparent or someone older that you admire, spend as much time with them as you can. There's a level of maturity and life experience that comes with age, and by appreciating them and all their wisdom while you have the chance, you'll learn more than you might ever have expected.

I'm sure you've heard the expression, "The best investment you will ever make is in yourself." While it can have many meanings, in this instance I am referring to the decisions you will make that will help you produce your wealth. Again, it doesn't happen overnight; it takes years of discipline, and a series of smart business decisions must be made slowly over time.

You're an entrepreneur. You're comfortable taking risks, and you understand risk and reward. You've trusted your own instincts in the past, and there's no reason not to as they relate to your business moving forward, and other opportunities as they arise. This mentality will be essential in moving forward with the three-buckets investment strategy.

And, it's not just a coincidence that this chapter is built around my real estate success stories; if you're willing to do the research and take some smart risks, real estate can work just as well for you as it has for me. That's where we'll begin in the next chapter.

NOTE: When you invest in yourself, your own business, and your own investing prowess, you're taking control of the outcome. With careful diligence, planning, research, and education, you can influence the outcome without having to rely on the stock market.

Chapter Summary at a Glance:

- Develop a true kickass entreprenuer mentality.
- Plow through your fear, and when you find the right opportunity, pounce.
- Educate yourself and then trust your instincts.
- Creating wealth doesn't happen overnight; it takes years of discipline and a series of smart business decisions that must be made slowly over time.
- Real estate is an amazing vehicle for creating wealth.

CHAPTER 3

Start Building your Empire through Real Estate

I know I stated it in the previous chapter, but I can't help myself; I just need to say it again.

I love real estate.

Real estate has supercharged my wealth, helped me create a long-term alternate passive-income stream, and been integral to my ability to semi-retire by the age of 49.

With real estate, I have control over the outcome of my investments; the more effort I put in, the better the results. As an entrepreneur, I like to be in control, both of the risks and the opportunities.

Real estate is also a fantastic hedge against inflation and it provides excellent asset appreciation. In fact, according to Forbes magazine, "after finance and then fashion, real estate produced the next largest group of self-made Forbes 400 members." (Forbes, "How Billionaires Get Rich," March 7, 2016)

There's also a feeling of accomplishment I get when I walk through my buildings, knowing that I'm not only making money, I'm providing an essential service for people. I take pride in my buildings, so the renters can, too.

Alhough I spend a great deal of time in this chapter and chapter 4 explaining the benefits of, and how to acquire direct ownership in a property, you don't need to purchase a building to take advantage of the great benefits afforded by investing in real estate. My preferred route of investing in real estate is direct ownership of an investment property, but how you choose to allocate the real estate bucket depends on several factors.

Allocating the Real Estate Bucket

There are many ways to invest in the real estate market, but there are three that are most common for the small investor and work especially well for entrepreneurs and business owners:

1. Real estate investment trust (REIT)
2. Real estate crowdfunding
3. Real estate direct ownership

Although there's no hard and fast rule, if your business is generating profits of under $100,000 per year, and your cash position is at $200,000 or less, investing directly in real estate and purchasing an investment property might prove difficult. If that's where your business is currently, options 1 or 2 might make more sense for you, particularly option 1: investing in a REIT.

REITs

A REIT is a company that owns and operates one, or generally many, real estate properties, usually with a specialization in a particular market sector. For example, you can acquire a REIT that specializes in industrial, commercial, multi-unit residential, healthcare, retail, mortgage, or other sector properties, and for that matter, by geographies.

Purchasing and selling REITs is super easy because most of them trade on the stock market; you can buy and sell them with the push of a button. They are very liquid, which is perfect for the smaller entrepreneur looking for real estate exposure without the hassle of direct ownership. Another bit of good news is that you can diversify your REITs across several companies, asset types, and geographies. So, if you have $100,000 to invest, you can purchase five different REITs. Aside from your rights as a shareholder, however, you have limited control, if any, over the decisions the trust makes, including financing, purchasing, or selling.

It's important to remember that purchasing a REIT is like purchasing a public company on the stock market; not all REITs are created equal. When you purchase a REIT, you're counting on someone else to make the right decisions. You therefore need to do your homework on the strength of that particular trust's management, balance sheet, and overall risk exposure before you decide to purchase it. Keep in mind, there are hundreds of REITs to choose from in the USA and Canada.

Generally, REITs provide a moderate long-term capital appreciation, or at least they hope to. They are also required to distribute 90% of the rental income to investors every year, meaning they actively provide strong expected distributions (known as dividends) to their investors. When researching REITs, look for companies that have a track record of capital appreciation and dividend yield.

Throughout this chapter I have included ratings of each real estate investment option based on five criteria:

– The level of purchasing complexity,
– Potential financial upside,
– Level of control,
– Overall liquidity, and
– Overall risk.

Using a scale from one to ten, with one being low and ten high, you can quickly and easily compare each option to see which best suits your needs and abilities.

REITs

– Level of purchasing complexity=3

    Do your homework, then press BUY on your computer. A REIT is a great choice for the novice investor.

– Potential financial upside=6

You don’t have any control of the outcome, but if you buy right, you could do well.

– Level of control=1

  You have no control, aside from being a shareholder with very limited rights.

– Overall liquidity=10

  In most cases, the REIT is traded on a public exchange.

– Overall risk=4

There still is an element of risk, since you’re investing in the real estate sector, but across a broad cross-section of properties.

Figure 3.1		
		REIT
	Level of purchasing complexity	3
	Potential Financial Upside	6
	Level of control	1
	Overall liquidity	10
	Overall risk	4

As mentioned, investing in a REIT is an excellent choice for beginner investors who either don’t have the time to own and manage real estate or don’t have enough capital to put a down payment on their own property. Another similar option for the new entrepreneur and investor is to take a crowdfunding approach.

Real Estate Crowdfunding

The concept of crowdfunding has been around for many years. You may be familiar with sites such as IndieGoGo or Kickstarter, platforms that facilitate the funding of a charity, creative project, idea, or start-up business by individuals or individual businesses, collectively forming a “crowd.”

Since the early 2000s, the real estate crowdfunding model has grown significantly, especially with the popularity of the internet. Just as with funding a venture through IndieGoGo or Kickstarter, when you invest in a crowdfunded real estate project, you pool your money with a group of people to make an investment. When you do so, you will be provided with the investment term or holding period information that details the length of time between your initial investment and the time you're repaid that initial investment, plus the stated earnings.

The average holding period for most crowdfunded real estate deals is four to seven years, which means your dollars will be tied up for that length of time. If you read the fine print on most crowdfunded real estate deals—and you definitely should—you will notice language like: "The estimated investment holding period described herein is only a projection, and there can be no assurance when or if an investment may be liquidated." This statement basically means that it may be a long time before you receive a return on your investment—if ever.

In some respects, real estate crowdfunding is similar to investing in a REIT, but a REIT has much more-stringent financial control and is significantly more liquid, since it can be bought and sold like a stock on the stock market. Obviously, if your money is wrapped up in a real estate deal for four to seven years, it's not nearly as liquid.

With a REIT, your funds go into a large pool and the dollars are invested across a broad number of projects, and potentially geographies. In a crowdfunded real estate project, your invested dollars go into a specific project or building, giving you greater control over the type of investments, geographies, and projects you want to allocate within your real estate investments.

In fact, it's possible that the beautiful new apartment complex being built in your neighborhood is actually open to investment through a crowdfunding site, giving you the opportunity effectively to become a minority owner in the building. While crowdfunding once was open only to accredited investors (you had to have a significant amount of wealth to get involved), in many instances today that is no longer the case and it is possible to invest as little as $500. That means you can spread your investment dollars across a broad number of properties and geographies.

There are many crowdfunding real estate websites and in most cases, each site will allow you to specify the types of investments in which you are interested in participating. For example, if you're looking for retail and MUR property investments in the state of California, you can set up alerts to be notified every time one is listed.

Crowdfunding websites generally include all of the pertinent information regarding an investment. When looking over potential investments online, do your due diligence and consider some of the following questions:

– How long has the company offering the investment been in business?
– How many other projects has it done, and what do its historical returns look like?
– What fees does the company charge its investors?
– What is the company's strategy, niche, and/or geography?
– Has it had any defaults? If so, why?
– Does the company put its own funds in the deals?
– What is the company's management like? Does it have a proven track record?
– Are you able to investigate some of the legal and engineering reports related to the properties offered?
– What is included in its projected pro forma statements?
– Does the company have a market report?

With the market report, make sure you understand all of the data related to the project. Check out the crime rates in the neighborhood, local property taxes, and if investing in a MUR, the school district rankings. You'll also want to familiarize yourself with the local rental market to compare rates in the area. If the investment is based on the proposal of a new luxury building in an otherwise downtrodden neighborhood, with rents well above market, you need to consider the risks and rewards. It's also important to learn about the demographics and the size of the population. For example, is the city or area growing or changing? If so, how and why?

Projected pro forma statements explain what you can expect with regards to receiving distributions. You want to understand what those dividends will be and whether the company has a track record of distributing those payments for other similar projects. If you invest $1,000, for example, what type of dividend payment can you expect and how often?

Using the same investment criteria as for the REIT analysis, I have rated the crowdfunding real estate investment approach.

Crowdfunding Real Estate

- Level of purchasing complexity=6

  Although in theory it's as simple as clicking "BUY" on a website, there's much more due diligence required.
- Potential financial upside=7

  The financial upside is potentially better than a REIT, but there's significantly more risk.
- Level of control=6

  You can pick and choose the properties, areas, and sectors, so in that regard you have more control, but you have little to no influence on the success of the property itself.
- Overall liquidity=5

  Crowdfunding investments don't trade on the open market, so you're at the mercy of the company.
- Overall risk=7

  There's almost as much risk as owning the property yourself, but in crowdfunding you're counting on the expertise of the company management.

Figure 3.2		
		Crowdfunding
	Level of purchasing complexity	6
	Potential Financial Upside	7
	Level of control	6
	Overall liquidity	5
	Overall risk	7

As you can see, there's clearly more risk involved in crowdfunding real estate investing than investing in REITs, so you need to do significantly more due diligence. That said, you can and should expect the platform that you're working with to do much of that initial due diligence, and the larger ones typically do. I've heard, although anecdotally, that in some cases, these sites only list 5% to 10% of the deals that cross their platforms, and with the two I am familiar with, Realty Shares and Realty Mogul, according to their websites that is in fact the case. Still, that doesn't absolve you from doing your own due diligence, so proceed cautiously.

And, if you're already doing so much research, and your financials allow it, maybe you should consider the next big step: direct ownerswhip.

Direct Ownership

Although there are many real estate categories, including retail, commercial, industrial, trailer parks, healthcare, and so on, I suggest entrepreneurs begin their foray into real estate with multi-unit residential, which I focus on throughout the rest of this chapter and the following one.

- For the smaller investor, MUR is not only the most popular, but the easiest and least risky to get into. The cost "per door" in MUR is significantly less than in commercial, retail, or industrial, so your investment will be spread over a broader base of customers. If you lose a tenant in a ten-unit (door) apartment building, you'll still be collecting rent from the other nine. If you lose the primary tenant in an industrial building, it could take months to fill that space and your cash flow from the property disappears during that period.

Think of buying property in terms of diversifying your business's profits, your 1/3 reserve, by putting it into rental real estate. Real estate, combined with the growth of your business, will help fuel your net worth. You will need to start by using some of your cash as a down payment on a rental property. Over time, you'll pay off that debt, improve the property, raise rents, rinse, and repeat.

It's important to note that I am referring specifically to real estate that provides a steady stream of income, hence the term "investment property." Your home, cottage, or sunny Caribbean paradise doesn't count since it is not a revenue-producing asset. Although they should be included in your net worth, they do not generate revenues. The type of real estate I'm focusing on can produce incredible returns and contribute directly to increasing your wealth.

As you improve the property over time, you hope your income will rise more than your expenses. Real estate is an asset and will always be in need of repairs, upgrades, and maintenance that will have an impact your bottom ine, but over the long-term the investment reward will more than outweigh the downsides.

While there's no guarantee that your property's value will increase, real estate has traditionally proven to be an excellent hedge against inflation, averaging a 3% increase per year over the past seventy-five years in North America, a type of long-term asset appreciation that's a fairly safe bet. Of course, it's certainly possible that real estate can go down in value, and each geography, city, and area will vary. Historical returns are no guarantee of future returns. In addition, just like in any business, real estate has elements of risk.

But then, with risk comes reward, and if you approach your investment properly, the rewards will follow. For example, as you pay down your mortgage on your MUR, the value of your equity increases.

Let's say you purchase a $1M property with $300K down. Your mortgage will be $700K; it's a lot of money, right? Well, assuming a 25-year amortization with 4% interest, after ten years the value of your mortgage will be $497,485. Not including property appreciation (which you're going to get), you will have added slightly over $200,000 to your wealth while still making a positive cash flow from the rental income. Add the profits and building increase, and you're looking at some significant returns on your initial $300,000 down payment (I review more of the calculations and provide a more in-depth explanation in chapter 4).

Obviously, it's up to you how to approach your direct ownership real estate investment, but that in itself is another great benefit, your ability to control the outcome, which is at the heart of any entrepreneurial endeavor. You have the ability to take risks by making strategic decisions about the building.

You can invest in upgrades and tenant decisions, vacate and upgrade units as necessary,raise the rents, and improve the building's valuation overall, abilities you definitely don't have in a REIT or crowdfunding, in which you're at the mercy of the company's management.

When I bought my first building, I noticed several things wrong with it, including some fundamental issues that I felt had an impact on the building's ability to attract tenants. For example, the prior owner had replaced all of the bulbs in the building with low-energy, low-wattage, low-level lighting, producing a low yellow glow in the hallways. Combined with the dark yellow paint throughout the building and the beaten-up linoleum flooring, the place looked a bit like a brothel—not that I've ever been to one, but I can imagine.

I replaced all of the lighting with bright new fixtures, painted the building with a light beige interior, and installed new ceramic slip-resistant flooring. When prospective new tenants walked into the building, the first thing they noticed was how beautiful it looked and how it was so well-cared for. Those fairly small cosmetic changes immediately made it easier to command higher rents, but still attract tenants.

Next, I developed a website as an online portal for tenant applications, featuring professional-looking photos of the units and building, and information about the property. That more-professional approach to managing the building had been lacking, and in no time I saw results.

You just don't have this level of control when you purchase a REIT or go the crowdfunding route, and for those reasons I have a strong preference for owning my own properties.

Direct Ownership

- Level of purchasing complexity=10

  You need to understand the market, rental conditions, and landlord responsibilities.
- Potential financial upside=10

  You control the decisions, so you can control the overall outcome. That's not to suggest the building won't ever lose value, because it might, so the level of risk is much higher.
- Level of control=10

  You own it, so you decide!
- Overall liquidity=7

  If you decide you no longer want to be a landlord, or if you wish to sell the building, you can. In that way it's actually more liquid than owning real estate through crowdfunding.
- Overall risk=9

There's clearly more risk, but you benefit from the upside in return. Remember, though, you're an entrepreneur, and that's what you do—take the risk, reap the reward).

Figure 3.3		
		Ownership
	Level of purchasing complexity	10
	Potential Financial Upside	10
	Level of control	10
	Overall liquidity	7
	Overall risk	9

When you're at the right financial stage and have enough cash saved so you can put at least a 25% down-payment into a triplex or larger building, I suggest you purcahse your own real estate. In the next chapter, I'll walk you through the details, show you the specifics on how to increase a building's valuation, and harness the awesome power of this investment bucket for any entrepreneur.

Chapter Summary at a Glance:

- There are three main ways of investing in real estate:
  - Real estate investment trust
  - Real estate crowdfunding
  - Real estate direct ownership

- A REIT is a company that owns and operates one or generally many real estate properties, usually with a specialization in a particular market sector. Investing in a REIT is an excellent choice for the beginner investor who either doesn't have the time to own and manage a property or enough capital to put a down payment on a property.

- Real estate crowdfunding is similar to investing in a REIT, but with less control and less liquidity. Although there's almost as much risk in crowdfunding as in owning an investment property, in crowdfunding you're counting on the expertise of the company management to make the returns for you.

- For the smaller investor, MUR is the easiest way to get into real estatet investment and the least risky. The cost per door in MUR is also significantly less than commercial, retail, or industrial properties.

- Direct ownership of real estate has many benefits, most importanlty your ability to control the outcome, which is at the heart of entrepreneurship. The risk is higher, but so is the possible return.

- A summary of the control, liquidity, and risk of the three options discussed is:

Figure 3.4				
	The Kickass Real Estate Investment Scale			
		REIT	Crowdfund-ing	Owner-ship
	Level of purchasing complexity	3	6	10
	Potential Financial Upside	6	7	10
	Level of control	1	6	10
	Overall liquidity	10	5	7
	Overall risk	4	7	9

CHAPTER 4

The Mechanics Behind the Transaction

In 2014, I got a call from my insurance company about the 21-unit building I own. It turned out they no longer wanted to insure the property unless we removed any and all knob and tube electrical wiring from the units. Knob and tube is an older type of electrical wiring that was used up until the 1930s, and insurance companies are reluctant to insure buildings with that wiring because of a perceived increase in risk. I had two months to comply, after which I needed to sign an affidavit confirming the building no longer contained knob and tube. Otherwise, I needed to find a new insurance provider or I was screwed.

Only two of the units had such wiring, so you'd think it wouldn't be a big issue. The problem is, both were occupied and well below market because of their rent-controlled status. A good deal for the renters, not so much for me. It was going to cost thousands to replace the wiring, patch all of the holes, and repaint. At that point, I could spend a few extra dollars to retrofit the units entirely.

The tenants in those two units were paying $900 per month each in rent, and the going rate for a retrofitted unit in the same building commanded a rent of at least $1,500 per month, a difference of $600 per month, or $7,200 per year per unit.

I couldn't kick the tenants out. I had the option of asking them to leave for two months while I retrofitted the unit, but once done, because of rent control I would have to give them their units back at the same rent. It just didn't make sound financial sense, and as an entrepreneur, I'm always making sure I don't lose out on any deal.

I ended up paying the tenants thousands each to leave their units. All in, including the fees to vacate the units, and the upgrade costs, I spent at least $45,000 per unit and rented the renovated units at $1,500 per unit per month. Though it felt like a hit at first, when I was done, the units were gorgeous.

On the surface, I had a 6¼-year payback:

Let's look at the math: $45,000 in upgrades/$7,200 per year in rent increase=6.25 years.

Not bad.

At a 3.5% CAP rate, which this particular building is currently valued at, the $7,200 per year rent increase amounted to an increase in the building's worth of over $205,000:

($100,000/3.5)X$7,200=$205,714.

Hang tight, and I will explain the above calculation shortly.

The $45,000 will provide a 6.25 year payback, and the $45,000 spent will result in a building valuation increase of more than $200,000. Multiply that by the two units I retrofitted, and I spent $90,000 to get a $400,000 increase in net worth.

Granted, I didn't sell the building. But, you get the point: I spent $90,000 and improved the yearly cash flow by over $14,000 per year, a 15.5% return. Now, imagine doing that over and over and over again.

NOTE ABOUT RENT CONTROL: As a landlord, I'm not a big fan of rent control, but it's important to note that many of the jurisdictions in North America, and around the world for that matter, have varying levels of rent control that limit the ways in which a landlord can raise rents and evict tenants. It's important that you understand the regulatory landscape where you own a building, as it will definitely have an impact on your returns. For example, you might be restricted by the dollar or percentage amount you can raise rents every year for an existing tenant, and in some jurisdictions you might even be restricted from how much you can charge new tenants.

If you do the math and do some sleuthing to find an ugly duckling building in a Prince Charming neighborhood, throw in a lot of elbow grease and rely on the power of leverage, then you, my friend, will be sitting on a gold mine. It all starts with investing a few thousand dollars in the building. Then you can raise rents. You'll watch the value of your property increase many times over, and you'll get a quick return on investment (ROI).

Sounds easy, right? Well, in a way, it is. But with this particular investment bucket, specifically direct ownership, the old expression holds true: the devil is in the details. It takes time to find the right property in the right neighborhood, but what's of equal importance is the math behind the transaction.

The Details

I've spoken with countless numbers of entrepreneurs over the years about purchasing real estate. Each time, there's some confusion with regards to what to look for from a numbers perspective. Even then, a discussion around the specific calculations always ensues.

You'll find, however, that if you take the process step by step, you will develop an understanding of the math—a true numbers perspective. In my opinion, the most important number you're going to need to consider when comparing investment real estate properties is the CAP rate. So let's start there.

CAP Rate

By now, if you've been reading closely, you've noticed that I have mentioned the CAP rate (capitalization rate) more than once. Investment real estate, including MUR real estate, is bought and sold on that multiple.

As I mentioned in Chapter 2, the CAP rate is defined as the net operating income (NOI) divided by the current market value.

For example, say the real estate value of a building is $1 million. After expenses, the NOI, not including mortgage, debt repayment, or interest charges, but before taxes, is $60,000. The property's CAP rate therefore is 6%:

$60,000/$1 million=6%.

All rental property trades on the CAP rate, so that's the first thing a discerning entrepreneur should look at when buying or selling a building.

CAP rates vary by city, neighborhood, pockets within a neighborhood, and current market conditions. A building in one section of a city can trade at a 4% CAP rate, while at the other end of the city a similar building can trade at 7%. Two blocks over, and you might be trading at 6%. So, although there is some subjectivity associated with the CAP rate, it's quite defined.

Now let's do some backward math. If I told you that a building's NOI is $100,000 and the building has a CAP rate of 5%, we can determine the value as follows:

CAP rate=NOI/Building value (BV)
5%=$100,000/BV

BV=$2 million

Revisit the math I used in the section on long-term asset appreciation at the beginning of this chapter. I mentioned that the CAP rate in the building was approximately 3.5%. I raised rents by $7,200. So, to find the BV, we just work backwards as we did with the previous example:

3.5%=$7,200/BV

BV=$7,200 / 0.035

BV=$205,714

At a 5% CAP rate, every extra dollar you raise rents or lower expenses, in turn improving NOI, you increase your building's value by $20.

> IMPORTANT NOTE ABOUT CAP RATE: Many listing agents will play games with the building's CAP rate to make the building appear more desirable than it actually is by "inadvertently" leaving out some key expenses that must be included in the CAP rate calculation. I've caught many agents in this CAP rate lie. They're invariably hoping to appeal to the novice investor who might not be completely aware of these games.

ABC Roofing

Let's look at how this all works with an example, using a fictitious company called ABC Roofing. Joe, the owner, has a substantial portion of his wealth, more than 50%, in his business. The math used in this example is based on some assumptions that will vary greatly depending on the city, area, interest rates, market, and timing, but in this case we can assume some average returns, CAP rates, and interest rates.

ABC Roofing finished the past fiscal year with revenue of $6 million and profits of $663,000. Most businesses are valued as a multiple of EBITDA at generally 4.5 to 6 times, so let's use 5 for the sake of simplicity. The value of the equity portion of the business is therefore $3,315,000:

$663,000X5=$3,315,000

Joe has also saved $2,400,000 in cash in his holding company over the years.

Let's assume Joe's home is valued at $400,000 with a $100,000 mortgage. He has $300,000 equity in the home. (Whether you include your home in the value of your business's net worth has been debated, but it is accepted that you include the value of your home in your total wealth.)

Here's how Joe's financials look:

Figure 4.1		
	Totals	**Percentage**
Cash	$2,400,000	39.90%
Equity (Business)	$3,315,000	55.11%
Real Estate	$300,000	4.99%
Total Net Worth	$6,015,000	100.00%

If Joe used $400,000 of his cash, he could comfortably purchase a building worth $1.2 million, with 33% down.

NOTE: Please visit TheKickassEntrepreneur.com/Excel where you will find an Excel document featuring a mortgage calculator. This Excel document will be referred to several times throughout the rest of this chapter, so please download the document and follow along.

He wants to buy a building in Springfield, where he lives. The real estate particulars for Springfield are as follows:

Average CAP rate=6%
Average cost per door=$100,000
Amortization term=25 years (cell B7 in the Start_Here tab in the Excel document)
Interest rate=4% (cell B8 in the Start_Here tab)
Down payment=$400,000 (cell B4 in the Start_Here tab)
Mortgage amount=$800,000

Purchase price=$1,200,000 (cell B3 in the Start_Here tab)
Net operating income=$72,000/year (cell B54)
Apartment building=12 units (doors)

Monthly revenue=($72,000/12)=$6,000 per month
Mortgage payment=$4,222 per month (calculated, see cell F9)

Amount after mortgage=$1,778 per month
Profit per year (before tax)=$21,327 per year (cell C64 in the Start_Here tab)

That means that if Joe puts down $400,000, he will receive $21,327 per year in income—a 5.33% return on his investment.
Keep in mind, this return is in the first year alone.

Joe can incrase the value of his property by upgrading and improving the grounds, units, and overall building. He can then raise rents and increase revenues. Of equal importance, Joe will receive a return on equity from paying down the mortgage. With every extra principal repayment Joe makes, he's increasing his net worth.

By the way, now that Joe has bought an income-generating building, his wealth mix has changed:

Figure 4.2		
	Totals	**Percentage**
Cash	$2,000,000	33.25%
Equity (Business)	$3,315,000	55.11%
Real Estate	$700,000	11.64%
Total Net Worth	$6,015,000	100.00%

If Joe's business makes another $600,000 or more the following year, he can purchase another building with $400,000 down, and that will once again increase his overall real estate percentage. Let's see what that looks like.

For simplicity's sake, let's assume that Joe's business has another $6M year with $663,000 in profits. If Joe puts another $400,000 into real estate, here's what his wealth profile will look like:

Figure 4.3		
	Totals	**Percentage**
Cash	$2,263,000	33.89%
Equity (Business)	$3,315,000	49.64%
Real Estate	$1,100,000	16.47%
Total Net Worth	$6,678,000	100.00%

I've simplified the math and didn't factor in mortgage pay-down or a return on Joe's investments in the above calculation. In fact, Joe would have paid down part of the mortgage and his real estate and would now have an additional $10,000 in equity on his first building. Presumably, he would have earned a return on his cash investments.

There's clearly some complexity here, but don't get discouraged. If you don't fully understand all of the math, that's ok; my hope is that this will serve as an introduction to your entrance into the real estate bucket.

Although I believe the entrepreneur's three bucket weightings should be equal, the exact 33% allocation isn't necessary. You will notice that although Joe's wealth isn't split into equal thirds yet, over time he can slowly but surely move his profits into real estate so that all three buckets are equal.

Assuming Joe's business continues to produce approximately $600,000 in profits, and if he continues to allocate $400,000 every year toward real estate, his percentage of wealth in real estate will increase in the coming years. For example, here's what his portfolio will look like two years out:

Figure 4.4		
	Totals	**Percentage**
Cash	$2,526,000	34.41%
Equity (Business)	$3,315,000	45.16%
Real Estate	$1,500,000	20.43%
Total Net Worth	$7,341,000	100.00%

AN IMPORTANT NOTE ABOUT TAXES: For the purposes of comparision and simplicity, taxes that must be paid on business and real estate income or capital gains have not been factored into the material throughout this book.

As Joe pays both principal and interest payments on the property, he will eventually have a higher equity value in the real estate bucket, and if he does a kickass job fixing up the units, he will improve the value of the building based purely on the CAP rate increase alone. In the meantime, rents increase on the property every year and in turn, so will Joe's profits. The real estate produces other profits such as:

Recall that Joe's profit per year (before tax) is $21,327 (cell C64 in the Start_Here tab). At the end of the 12th month after his initial purchase, Joe will have a principle balance of $780,981, which means that assuming the building is still worth $1.2M, he would have improved his net worth.

> The increase in net worth from mortgage pay-down: $800,000-$780,981=$19,019.
>
> Joe's total net worth increase, including building profits and equity value increase: $21,327+$19,019=$40,346.

Remember, Joe put down $400,000 initially on the $1.2M building and has now improved his net worth by $40,346, a 10.09% return on his initial investment.

At the end of year five, his return on invested capital is 52%, and by year ten 110%, as shown in the table:

Figure 4.5			
		End of	**End of**
		Year 5	**Year 10**
	Initial Mortgage	$800,000.00	$800,000.00
	Mortgage Remaining	$696,836.93	$570,875.17

	Increased Equity	$103,163.07	$229,124.83
	Accumulated Profits	$106,638.32	$213,276.63
	Total Return, Profits and Wealth Appreciation	$209,801.39	$442,401.46
	Return on initial investment	52.45%	110.60%

Cell B90 of the Excel document (sheet start_here) is titled "Building Appreciation." With a presumed 3% year-over-year appreciation—the historical amount that real estate has appreciated over the long-term, as mentioned in chapter 3—in ten years, Joe is looking at a 213% return on his initial $400,000 investment!

Figure 4.6	
	End of Year
	10
Building Value	$1,612,699.66
Initial Mortgage	$800,000.00
Mortgage Reamaining	$570,875.17
Increased Equity from debt pay-down	$229,124.83
Increased Equity from building appreciation	$412,699.66
Accumulated Profits	$213,276.63
Total Return, Profits and Wealth Appreciation	**$855,101.12**
Return on initial investment	**213.78%**

NOTE: Feel free to play with the Excel document to see how profitability and returns develop over time. For example, if you change the interest rate to 3%, your return after the first year increases to 12% (cell F7) and profits increase to $26,476 (cell F5). Next, go to the Monthly_Amoritization tab, and in cell G16 add the number $30,000, which is a one-time larger than normal payment made in the second year. Now when you look at cell G10, you'll notice that you've saved $48,525 in interest payments.

Remember, Joe is an entrepreneur; he wants to take control of his destiny. Investing in real estate will allow him not only to diversify his wealth, it will allow him to do what he does best: manage his business and create wealth.

Joe is capitalizing on the fact that real estate has proven over the past many decades to be one of the largest generators of wealth. As a major component of his three-buckets strategy, he's well on his way to building a succesful portfolio tailored to his entrpreneurial lifestyle and business.

Time Well-Spent

Despite these massive returns, I understand that you may have some reservations; purchasing and maintaining an income-generating property can be a lot of work. At this point, you may be thinking that real estate is a time and cash diversion that might not make sense for you since you're already super busy.

It's true that any way you cut it, shopping for and maintaining real estate takes time. But, you're not fully on your own. When you shop for real estate, the pro-forma income statement should always include property management fees, and in-turn, the CAP rate. Therefore, all of the assumptions I've made in this chapter presume you hire a property manager.

Entreprenuers need to stay focused on their businesses, but if you're going to go down the path of direct ownership with the real estate bucket, you should also allocate some of your time away from your business to work on acquiring an investment real estate property. Trust me, it will be worth it.

While it takes time and effort to learn about the real estate industry, if you look for a property that makes sense for you, work with the right lawyers, and shop for a bank willing to provide you with financing, the temporary time-diversion will, in short order, produce long-term gains.

After you have the first property under your belt and you've established relationships with a real estate agent, lawyer, bank, and property manager, additional properties will take significantly less time to purchase and manage. In addition, once you have your cadence and are past the initial time-consuming purchasing and set-up phase, the time commitment should be quite minimal. You can then refocus your attention on your business, while your real estate returns roll in.

As mentioned in chapter 3, REITs and crowdfunding investment options don't offer you the benefits of owning your own property. Over the long term, direct ownership will build your equity and pay out large inflation-protected dividends throughout your life.

Real estate ownership has created countless millionaires and billionaires. Since you're already building wealth through your own business, diversifying 1/3 of your wealth into real estate is an excellent next step in creating even greater wealth.

Real estate will continue to provide a hedge against inflation and will increase in value over time. I'm not suggesting that you put all of your wealth into real estate, of course, that is just the 1/3 allocation of your assets, as set out in the Talmud asset-allocation bucket strategy.

It's going to take time to build your portfolio—two, three, five, or maybe even more years—and you need to monitor it, but if you start now, I gurantee that someday you’ll see how it was time well-spent.

Chapter Summary at a Glance:

- As an entrepreneur, real estate can and should play a role in diversifying your assets and building your wealth.

- Diversifying your assets into rental real estate, while continuing to grow your business, will help fuel your net worth.

- CAP rates vary by city, neighborhood, and even pockets within a neighborhood. A building in one section of a city can trade at a higher or lower percent than in another section of the same city.

- After purchasing a property, improve your building and raise rents over the next few years to increase the value of the building and your returns.

CHAPTER 5

Equity Is Your Largest Asset

For twenty-seven years, I was the president of my own company, and if I'm honest, many of the days I spent at work were extremely challenging. There were quite a few times that I wished I didn't have to navigate the day-to-day stress of dealing with suppliers, customers, and staff. Yes, the company was profitable, and for the most part I really enjoyed what I did, but to say that I loved every minute of it would be a lie.

Some days were just—tough.

Around 2008, I had a conversation with my brother-in-law in which I suggested that I was frustrated enough to throw in the towel, sell the business, and do something else. At that time, I didn't have nearly enough capital to retire, the business wasn't worth that much, and furthermore, I was way too young to call it a day. I wasn't loving life, though. I had to put in long hours and growing a business was hard work, made even harder by raising two kids, who were then eight and ten years old. Frankly, those were really difficult personal years.

But my brother-in-law said something to me that I never forgot, using an expression that strongly resonated with me. He said, "Jeff, if you sell your business now, you're going to kill the goose that lays the golden-egg." He then asked, "What are you going to do after, and what are you going to do that has the potential your current business has?"

He was right. My business was profitable; it was growing. I was building wealth, and I had a plan. The fact that I wanted off the roller coaster for a brief momentary period was understandable, but I had to stay on the ride, life wouldn't let me get off.

Fortunately, I didn't sell the business. Instead, I tripled its revenue and more than quadrupled the profits in the same period. I transformed my business into a cash-generating machine.

Over the years, I've replayed that expression in my mind again and again: don't kill the goose that lays the golden egg.

Entrepreneurs need to build and structure their businesses like a goose that lays a continuous stream of golden eggs. They must focus on maximizing revenues and profits, and save as much as they can today so they can create wealth and financial independence tomorrow.

In other words, the plan is to build the **golden-business-goose** that lays a continuous and growing stream **of golden-business-eggs.**

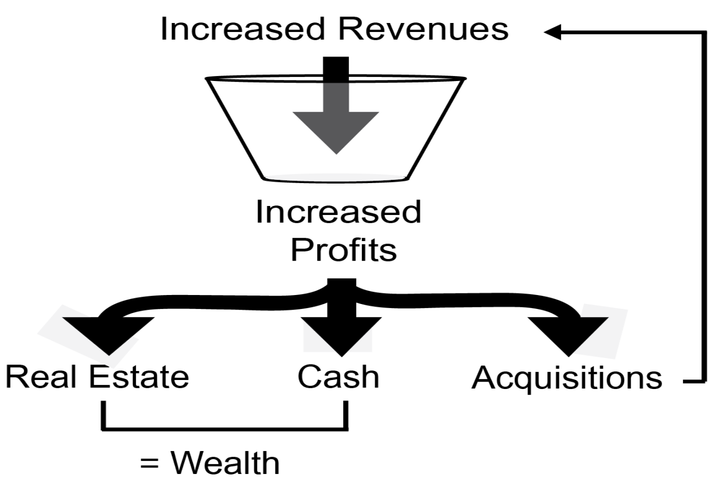


Figure 5.1

Take a look at figure 5.1.

This figure represents your ticket to financial freedom, the second of the three buckets, and your largest asset: your business. If you're doing things right, the greater the revenues, the larger the profits. The larger the profits—generated consistently, year after year—the more cash you'll have to invest in real estate, acquisitions, and other growth opportunities. The more acquisitions, the greater the revenues, and in turn, even greater profits. What all of this amounts to is: *the larger the profits, the more wealth you create.*

Let's take a deeper dive into this allocation bucket by first considering how your business is the best stock you're ever going to own, then looking at how profitability (more golden eggs) has an impact on your business's valuation. For those who might be interested in cashing out on the ultimate entrepreneurial prize when the time's right, I'll also review what's involved in getting your business ready to sell.

Your Business as Your Best Stock

In chapter 1, I discussed the fact that your business needs to be treated as equity, much in the same way investors view stocks in their stock portfolios.

As the business owner, however, you have a clear advantage over traditional stock investors. Unlike those investors, who sit by idly watching their stocks go up and down every day with no say over the businesses' success, you control the outcome of your business by placing your biggest bet on your best asset: YOU.

Not only are you in charge of the risks your business takes, you're also the one who reaps the rewards from those risks. In having your business at your disposal, you pull the growth levers, giving you the ability to scale as large as your risk appetite and skill will allow. In the end, how much growth and profitability you achieve is up to you.

According to *Forbes* magazine, the number one way the top 400 wealthiest individuals made their fortunes is through business ownership, great news for all you entrepreneurs ready to capitalize on your equity, grow your businesses, and improve profitability.

Although your business is clearly not as liquid as a stock that you can buy and sell with the push of a button, just as a stock's value on the stock exchange is impacted by its level of profitability and earnings per share, so is your business.

How Profitability Has an Impact on Your Business's Valuation

Your business's valuation is impacted by its level of profitability. As profitability increases, so does your business's value.

If you recall, in chapter 4 I discussed how raising apartment rents by a certain dollar amount has an impact on the overall building valuation exponentially. As an example, I showed how raising the rent by $7,200 per year on one retrofitted apartment increased the building valuation by more than $205,714. In a similar manner, increasing the profitability of your business will have an effect on your business's valuation, only in this case the math is slightly different.

There are many variables that are used when calculating the value of a business, but a multiple of EBITDA will provide a quick back-of-the-envelope business valuation. (If you need a quick refresher on EBITDA, please see chapter 1.)

Say you were to sell your company. A potential buyer would expect to purchase the business debt free, meaning that if your business has $500,000 of debt, and the business value is $2 million, taxes notwithstanding, you would receive $1.5 million in your pocket if someone were to buy your business. The buyer would purchase it with no debt, hence, no interest charges. If your business paid $100,000 in interest on the debt last year, the new buyer wouldn't incur that charge, and in turn, the buyer's profit would be $100,000 higher in the first year post-acquisition and every year thereafter.

The same holds true for the income taxes paid. Recall that the "I" in EBITDA stands for Income taxes, not payroll or realty taxes, which are part of operating expenses. If your firm paid $100,000 in income taxes last year, then once again, income taxes are added back to earnings in order to normalize your income.

Amortization is added back in because it is a byproduct of the consumption of intangible assets, and depreciation is a non-cash expense that reduces the value of equipment, cars, capital assets, and buildings.

Using the EBITDA to calculate the value of your business illustrates how a business's value is determined based on many different variables. The purpose of this discussion, however, isn't to make you an expert on business valuation, but rather to help you understand how improving profitability can help your business's value and put more dollars back in your pocket.

It's also important to keep in mind that the purpose of this book is to help you better understand and design the ultimate kickass portfolio for the entrepreneur investor, and as such, your business's valuation represents a sizable portion of your wealth, and needs to be accounted for in the 1/3 bucket strategy.

In chapter 4, I used ABC Roofing as an example to show how the real estate bucket can be a powerful part of your asset allocation. Let's use ABC again to look at the equity bucket.

As shown previously, last fiscal year it finished with revenue of $6 million and profits of $663,000. Let's use the multiple of five again with regards to EBITDA. (Remember, most businesses are valued as a multiple of EBITDA at generally four and a half to six times, so we used five for the sake of simplicity in chapter 4.)

A simple valuation of ABC Roofing would therefore be as follows:

$663,000X5=$3,315,000 (as business value)

If ABC Roofing's profits were $664,000 per year instead of $663,000, a $1,000 difference, the new valuation would be:

$664,000X5=$3,320,000

Notice how an increase of $1,000 in yearly profits improved the business's valuation by $5,000 ($3,315,000 to $3,320,000).

This small amount may seem insignificant, but when you're valuing, or selling your business, those dollars add up—fast.

Prior to selling my business, for example, I was able to renegotiate a large supplier contract, resulting in savings of $180,000 a year. Without divulging what EBITDA multiple I received, if I use five for math purposes, that one supplier contract renegotiation, taxes notwithstanding, put an additional $900,000 in my pocket.

If you're planning on running your business for years to come, and you've managed to save the company $180,000 per year, your profits have just increased by that same amount. In this example, when valuing your business to determine what number you should put into the 1/3 equity bucket, then you've just increased that number by $900,000.

As you can clearly see, every dollar counts.

Other than cutting expenses and increasing profits, there are many other ways of improving your business's valuation. Even if you're not in the market to sell your business today, it's helpful to know what levers have an impact on valuation and where to focus your efforts to help improve your business's overall strength in the market.

Recurring Revenue:

If I were to start another business today, the first thing I would look to do is add an element of recurring revenue. Recurring revenue is like the business gift that keeps on giving.

Running a business is hard work. Running a service-based business, or a business that needs a constant stream of new sales with no recurring revenue, is even harder work. Without recurring revenues, your business is only as good as your last month's sales. When business conditions slow, for whatever reason, you have less revenue to count on.

Recurring revenue provides a business with a steady stream of cash flow and makes it much easier to forecast revenue and profitability. It's like the golden business goose that keeps on giving. When I was running my company, the business really grew once we added larger elements of recurring revenue to the business.

Historical Earnings History:
If you have been in business for only two years, you obviously don't have much of a track record of success. It's great that your business made $1 million in profits last year, but how sustainable are the revenue and profits, especially if the revenue is not recurring? The longer you have been in business, especially with a demonstrable earnings history, the more valuable your business becomes.

Growth Prospects:
It goes without saying that if your business is in an industry that's struggling, declining, or being disrupted, the more difficult it will be to grow, unless of course, it's your firm that's doing the disrupting! Conversely, if you're in a rapidly growing industry with a potentially strong future and your business has experienced sustained growth for the past few years, your business valuation will continue to increase over time.

Client Concentration:
Do you have hundreds or thousands of customers with no one customer representing more than 2% of your revenue? Or is your business one in which you have a handful of customers, with your largest customer representing 50% of your revenue? The latter has a negative impact your valuation, whereas the former, especially with a large percentage of your overall revenue recurring with low attrition, will definitely help your valuation.

There are, of course, many other tangible and intangible variables that will have an impact on your business's valuation, including your brand, market, and social media presence, plus location and overall reputation.

Ultimately, better business leads to more profits, resulting in a higher valuation. Again, it goes without saying that more profits in the business results in more dollars in your pocket, and more investable dollars available for acquisitions, business expansion, and investments such as real estate.

When allocating your investments using the three-buckets strategy, putting a number into the 1/3 equity column is more of an exercise than an exact science in understanding your bussiness’s approximate value. Therefore, make sure you discuss all the details with an accountant, especially if you’re thinking about taking the final step in your entrepreneurial journey: selling the business.

When to Sell Your Business

If you’re in the later stages of running your business, and have contemplated potentially selling it, the first question you must ask yourself is why you started the company in the first place.

If you started your business because you were passionate about the industry you were entering, or you were simply excited by the prospect of running and growing a business, that’s enough of a “why” to have gotten you past the inevitable struggles early on and will likely influence your decision on whether to sell.

If you started your business looking for a way to make a quick buck, or a mega-million dollar sale, and that’s continued to be your sole motivating factor, selling the business now or in the future might be the right move for you.

Many entrepreneurs don’t take the time to contemplate what they want from their business, whether it’s regarding profits, long-term business growth, or more importantly, the lifestyle they want to lead. Most are caught on the entrepreneur merry-go-round, dealing with business issues, family, staff, banks, and so on, finding it difficult to even plan this year’s strategy, let alone figure out whether it’s time to sell.

When I started my business in 1991, I certainly didn’t think I’d be running the same company for twenty-seven years. And for twenty-six years, I thoroughly enjoyed the challenge of scaling that business. Over time though, I came to realize that I was no longer excited by the prospect of growing the company, and I didn't love going into work every day as I once had. I wasn't completely passionate about the prospect of growing the company to the next level, and I knew that if I didn't love what I was doing anymore, it was time for me to get out. It also helped that I had enough to retire, and I had decided that I was at the stage of life where I was ready to try something new.

My first day post-sale was bittersweet. The challenging M&A (mergers and acquisitions) process was over, I had the cash in the bank, and I was excited by the opportunities that lay ahead, but what I thought would be an easy personal transition was anything but. You can read as many books, articles, and blogs, or listen to as many podcasts or radio shows about a particular subject or event, but often, until you experience something for yourself, it's difficult to really appreciate what's in store. I hadn't realized how much of who I was as an individual was wrapped up in the business and in my relationship with my contacts, customers, team members, and suppliers.

My personal identity and my role as president of the company had become entangled, and I had lived that way for so long. It was difficult to truly appreciate what life would be like once my responsibilities as a business leader were over. I found that the silence of solitude can be deafening at times, especially considering how busy I was when I was president.

I am an entrepreneur at heart, and while I am now a minority shareholder in the company, the responsibility is much different. I sometimes miss the activity and excitement of scaling a company, of having people lined up at my door, of the exhilaration of making quarterly and yearly sales forecasts, and the feeling of accomplishment when meeting short- and long-term strategic goals.

I have come to realize about myself that I will always be an entrepreneur on the hunt for the next opportunity.

While having the money in the bank might buy some comforts, it's difficult to replace the human interaction and excitement that comes with running a company. I don't regret my decision, not for a second, because I love what I do today. I'm helping entrepreneurs kick ass, and reliving the adventure of entrepreneurship all over again.

So, before you decide that it's time to sell, think carefully about "why." Scooping up a few dollars might put a short-term smile on your face, but it doesn't replace many of the things you'll invariably miss, like the energy of running a business and the feeling of significance of being the head honcho.

Money can't buy that.

As your business matures and grows, so does your role. You may have begun as a one-person start-up, and now you're managing staff, setting customer expectations, creating strategies, and researching issues unrelated to your industry, all while dealing with business problems and putting out fires. This constant daily grind can wear you down rather quickly.

If your passion has waned, and you're finding it more difficult than ever to get excited about growing your business, then now might be the time to sell. Before you jump in feet first, though, it's important to take some specific factors into account, especially with regards to the health of your industry.

Onward and Upward or Down and Out

It's easier to grow a business that's in an evolving industry rather than one that's declining. If your niche was in the taxi industry in 2018, the physical video rental industry in 2010, or bookstores in 2005, I can't imagine how difficult business must have been, or in some cases continues to be.

Although you don't have a crystal ball, and it's difficult to tell what new trend or technology could threaten your business model, you need to be extra vigilant about changes in your industry, or related industries, that could ultimately make it more difficult to sell your company. If you recognize any shifting signals, then now might be time to act.

If all the signs are pointing to an impending downturn in your industry, it might be time to get ahead of the curve and get out while you can. But before doing so, you should also give some consideration to what your life post-sale might look like.

What to Do with Your Time Post-Sale

For starters, have you figured out what you're going to do after you've sold your business? You're going to have a lot of time on your hands, time that you're not used to having and that you're going to want to fill. Do you have any hobbies? Is there maybe a volunteer organization that you want to work for? Perhaps you've always dreamed of traveling? Or, would you like to go back to work, perhaps even start another company?

You need to give these questions some serious thought. As mentioned above, you may find that it's not time for you to sell yet.

Fortunately, there's time between when you decide to sell and the actual sale itself, so you will probably have a year to contemplate what you're going to do in your life after business ownership.

In my case, it took the better part of a year to figure out what exactly I wanted to do with my time. I did a lot of research and soul-searching, and although I had a sense of what I wanted to do, I wasn't entirely sure how things would work out. What I knew for sure was that it was time for a change and time for a new challenge.

Before I left, though, I made sure of two things: first, that I had a strong succession plan in place, and second, that my finances were in order.

Succession Plan

If you're hoping to sell to a financial buyer, private equity firm, or venture capitalist, you'll want to make sure you have a proper management team in place that can successfully run the company without you. (If you're hoping to sell to a strategic buyer then having a succession plan isn't as important.)

During the buyer's due diligence phase, if it looks like the business is going to collapse without you there, that will quickly become apparent. If you don't have proper succession in place, you'll need to work on moving other senior managers into the roles to replace you.

That way, you can leave the business with a clear mind and focus on your next steps. Of course, that's only possible if you're wealthy enough to retire, so you need to do some "due diligence" on yourself.

Finances:

Based on your business valuation, discussed earlier in the chapter, and your personal finances, if you sell your company, will you need to go back to work? If you find that you do need to go return to work, then you should question whether now is the right time to sell, especially if your company is profitable. There is also the possibility that you're selling in hopes of cashing out on the current business to start another one. Either way, you need to make sure you're in a financially stable situation to be able to do so.

If you're in a financial position where you can afford to, or at an age where you need to sell, you should call an M&A advisor who can help you through the process. You'll usually want to get in touch with one at least two to three years before selling to start learning what needs to be done to get your business ready for market. I was quite overwhelmed by the 150-line list of items of information that was needed. Start doing some housekeeping now and save yourself from a major headache later.

If you haven't generated enough wealth yet, it probably makes sense to work for a few more years until you have more money saved so that you can retire comfortably.

Or, if you're betting on a windfall from the sale of your company, and plan to live off the proceeds of the sale, then that could be an option as well. As part of that decision-making process, be sure to check with your accountant or financial advisor to plan out how much money you'll really need to live a comfortable life going forward; if you're not there yet, it's time to reconsider.

Chapter Summary at a Glance:

- As an entrepreneur, your business is your largest asset and the second of the three buckets integral to the three-buckets asset allocation approach.

- Build your business so it becomes a goose that lays a continuous stream of golden eggs; maximize revenues and profits and save as much as you can today.

- Cutting expenses and increasing profits are the main ways to improve your business's valuation, but there are other factors to consider as well, including,

  - Recurring Revenue
  - Staff & Management
  - Historical Earnings
  - Growth Prospects
  - Client Concentration

- Before you decide that it's time to sell, think carefully about "why."

CHAPTER 6

Cash is King

From today on, you need to start thinking differently about cash.

Access to cash is important for any entrepreneur. And as one of the buckets in the three-buckets investment approach, it needs to be considered closely.

No matter what your business is, cash can be used to purchase machinery and other capital assets and it's good to have some available in case of an emergency.

Also, there's always the potential that you might come across some exciting acquisition opportunities and you'll want to have a liquid form of capital ready so you can take advantage of them. If all your cash is tied up in the stock market, you might be forced to liquidate your portfolio at a loss in order to harness such opportunities.

Sometimes those opportunities present themselves when the market is tanking or the economy is in recession; that's the best time to take the big bets and pounce. If you don't have cash on hand, then you lose as your competitors—the smart ones that do have cash—will beat you to the punch. They'll be the ones making all-cash offers for a distressed business while you're stuck negotiating loan terms with your bank.

Before discussing the benefits of having cash on hand, let's first look at exactly what I mean by "cash" in relation to the three-buckets strategy.

The 1/3 Reserve Allocation

In chapter 1, I mentioned that the Talmud asset allocation strategy suggests that you maintain a portfolio with a third of your assets in reserve. Gibson and Faber interpreted the reserve as bonds, but it could also be interpreted as cash or other fairly liquid fixed-income secure investments.

The title of this chapter is "Cash is King," but when I refer to the term "cash," I am using it somewhat metaphorically. I'm not suggesting you literally hold cash in a safe deposit box, instead, you should hold liquid fixed-income investments.

As an entrepreneur, during the years when you're building your business and growing wealth, you don't need the added complexity of hedge funds, stock risk, or credit risk spreads. What you need instead is to have the cash side of your portfolio nicely tucked away, earning a modest interest through GICs, CDs, and money market funds. Yes, I understand that those funds pay a paltry 2% to 3% return, but remember your biggest return will be from your own business and the risks you're going to take with your business and the other bucket, real estate.

The profit returns I made with my business, and from my real estate investments, far outweighed the lost opportunity from not having my cash invested in the stock market. Plus, I knew that if I ever needed access to cash for whatever reason, it would always be there.

Entrepreneurs' wealth doesn't come from the stock market, it comes from the increased profitability of their business, from strategically investing in acquisitions, income-producing real estate, and from smart decisions and a willingness to take risks.The rich get richer by investing in themselves, not by hitting home runs in the stock market.

I have always taken a more conservative approach to investing the 1/3 cash, or reserve allocation in the three buckets, knowing that I have more control over my other two buckets, as discussed throughout the chapters. I can then focus on wealth creation through my business and real esate, knowing my cash is safe for when I need it the most. My reserve investment mix can be found in the "Investment Mix" table:

INVESTMENT MIX	
CDs, GICs, 1 to 5 year ladder	30.00%
Bond ETFs	30.00%
Money Market Funds	20.00%
Blue Chip Dividend Paying Stocks	10.00%
Tech Stocks	5.00%
S&P Index ETFs	5.00%
Total:	100.00%

A CD or GIC one to five year ladder is a strategy in which you divide your funds into equal amounts with different maturity dates between one and five years. Since your CDs or GICs will mature at different times, this strategy will provide you with a steady stream of cash flow over the years.

This portfolio is a simple to follow, "set it and forget it" allocation, composed mostly of a safe and secure "cash" portfolio with 20% in the equity markets. The small allocation in dividend-paying stocks, tech stocks, and the S&P gives me the sense, albeit a small one, that I am participating in the upside of the markets.

As you can see, the bulk of the portfolio earns a small return, but that's fine since once again, your business and real estate buckets should be appreciating and doing well. If you follow this investment mix, if and when the market turns you will have the security of the fixed-income allocation of the portfolio, you will be well-diversified, and you will be able to pounce when the time is right. And the ability to take advantage of such new opportunities comes from the power of cash.

The Power of Cash

I wrote it at the beginning of the chapter, but I want to emphasize it once again: If you don't have cash, you lose.

You lose because your competitors can swoop in on new opportunities while you're twiddling your thumbs trying to free up money.

You lose because the owner of that beautiful piece of real estate you want to buy—the one that was trading at a 4% CAP rate before the recession but is now trading at an 8% CAP rate—wants an all cash, quick-close deal, cash you don't have right now.

You lose because you don't have enough cash to purchase that piece of machinery you need to expand your printing press, that new truck in order to hire another crew and grow your business, or the competitor that's now near bankruptcy and looking for a few bucks for a quick exit, a few bucks that you don't have in hand yet.

To become a successful entrepreneur, opportunities often require that you sit patiently, almost stealth-like, waiting to act; you have to be nimble, prepared, and ready to attack.

And if you are, you win.

You win because now you're able to buy that distressed business or piece of real estate or new machinery. Then you can hang tight for a few years while the recession passes and land a quick return on your investment. When the storm's coming through, you'll be the one with the umbrella!

During the 2008 recession many people's homes were "under water." There were businesses barely making it, failing to even scrape by, and amazing employees who for no fault of their own, were out of work.

Of course, no one wishes for anything like the 2008 recession to happen again, but the fact of the matter is that some day it will; it's not a matter of if, just when. But if you have cash ready to go when it all starts heading south, you can go on a shopping bonanza.

It will feel like everything is on sale, an all-you-can-eat hungry-man buffet where you can walk around picking from a smorgasbord of depressed assets.

In 2008, I remember all of the beautiful opportunities that were floating to the surface, including apartment buildings selling for an 8% or 9% CAP rate (now selling for a 3% or 4% CAP rate) or the large competitor of ours I unfortunately didn't buy that was looking for a quick all-cash deal lowball offer.

Today, everyone's buying, but those same people probably wish they had been prepared with liquid capital. Now, that's the power of cash.

I quoted Warren Buffett earlier in the book as famously saying: "Be greedy when others are fearful, and fearful when others are greedy." Wise advice that you ignore at your own peril. Let's see why.

Pick One: A 233% or -267% Return

If you're willing to put yourself out there and be "greedy when others are fearful" you'll land some amazing deals by putting your cash to work. Let's consider purchasing a distressed piece of real estate at an 8% CAP rate, and what happens to your return on that investment when the same asset, many years later, is trading at a 4% CAP rate now that everyone is clamoring to get into the market.

Though I covered this material in a different capacity in the real estate chapter, the emphasis here is on the power of having cash available to purchase an asset at the bottom of the market and what happens when that same asset can be sold at the peak of the market just a few years later. Let's start out in 2008, considering an apartment building at an 8% CAP rate.

Apartment building at 8% CAP rate (2008)=$1,000,000 value
Income=$80,000
Down payment on property=30%=$300,000

Remember that the CAP rate is equal to the net operating income, divided by the building value (NOI/BV).

Now fast forward ten years to 2018. Although your NOI would have increased in ten years and you would have paid down a significant portion of the mortgage, let's keep the numbers the same for simplicity's sake once again. Your income is still at $80,000 and the mortgage is still at $700,000 after putting 30% down on the $1,000,000 building.

New CAP rate (2016, 2017, 2018)=4%
Apartment building at 4% CAP rate=$2,000,000
CAP rate=NOI/BV or 4%=$80,000/$2,000,000
Initial down payment=30%=$300,000
Increase in building value=$1,000,000 ($1,000,000 to $2,000,000)

You put $300,000 down and you made $1,000,000—that's a 233% return.

And remember, you would have increased rents during that time, perhaps renovated a unit or two, and would have paid down the mortgage by many thousands of dollars. Your return would therefore be closer to 300%, maybe even 400%.

Now, let's look at what happens when you buy the same piece of real estate at a 4% CAP rate and are forced to sell at an 8% CAP rate.

Building value=$2,000,000
Initial down payment=30%=$600,000
CAP rate=4%
Income=$80,000

Again, I will leave the income and mortgage constant to compare like scenarios.

Building value at 8% CAP rate=$1,000,000. A $1,000,000 loss in building value.

You put $600,000 down and you lost $1,000,000. Remember, you still owe the bank $1,000,000, but you only have $600,000 equity in the building. That means not only will you lose your $600,000, you'll still owe the bank another $400,000.

If you don't have $400,000 to spare, you'll either have to declare bankruptcy or sell other assets to cover the loss.

Your total return in that case= -267%

My Lost Opportunity

During the height of the 2008/2009 recession I received a call from a business broker who was selling a large competitor of ours.

A few pages ago I wrote, "the large competitor of ours I unfortunately didn't buy that was looking for a quick all-cash deal lowball offer."

During that time I was focused on building my real estate portfolio, and although I did take a look at my competitor's financials, I decided to pass. The owner was in desperate need of cash and needed a quick close. As such, the due diligence process would have to have been curtailed. I was uncomfortable with not doing a full due-diliigence and in the end, passed on what seemed like a beautiful opportunity.

The competitor's revenue was approximately $6 million, and profits about $400,000. The seller wanted a one-month close, limited access to the financial records, and was looking for $1 million for the business.

In hindsight, I could have turned the $400,000 profit into double that quite quickly because our businesses were very similar. We didn't need two office spaces, two sales directors, two accounts receivable clerks, and so on. I could have consolidated the two operations and turned the $400,000 in profits into $800,000 within one year. The payback on the purchase would have been in under eighteen months and would have provided an amazing long-term ROI.

As you can see, buying at the top of the market is quite different than buying at the bottom of it. Most people, however, decide to buy at the top because that's when they have the cash and are feeling exuberant. All of their friends, and the rest of the world, are screaming about how amazing real estate and other investments are, and they get swept up in the hype. In the meantime the banks are willing to lend, and the market is flush with cash.

But, kickass entrepreneurs are not like most people. They know when to hold 'em, and when to fold 'em, and they stay alert for the best deals at the lowest prices. Then, they take their stored liquid capital, 1/3 of their three-buckets allocation, and put it to use purchasing new assets and helping them grow their wealth through the power of cash.

Chapter Summary at a Glance:

- Cash is the king of the three-buckets asset allocation method.
- During the years you're building your business and growing wealth, you don't need the added complexity of hedge funds, stock risk, or credit risk spreads.
- Make sure the cash side of your investment is there, nicely tucked away, earning a modest interest through GICs, CDs, and money market funds.
- If you don't have cash, you lose.

If your competitors have cash, they will beat you to the opportunities, such as distressed businesses when the market is in a lull.

Conclusion

I'm sure you've seen or heard the stats: According to Canada's Small Business Association (SBA), 30% of businesses fail in their first two years, more than 50% in the first five years in business. Of those that survive, many are barely profitable. If you're one of the lucky entrepreneurs whose business is profitable and growing, you need to think about how to continue that growth. As you've surely picked up on by now, the best way to do so is by investing your profits toward business growth and building the ultimate kickass personal portfolio.

That approach relies on the three-buckets strategy, with which you're familiar by now. You should be thinking about your business as equity, real estate as an amazing wealth-creating vehicle, and "dry powder" (cash) as a way to take advantage of market or acquisition opportunities while acting as a hedge against market downturns.

The first step, categorizing each investment into real estate, cash, or equity, shouldn't be too hard, but from there things can get pretty complicated. I hope the lessons in this book have helped clarify that process and will inspire you to start investing like a real kick-ass entrepreneur, using the three-buckets strategy to create your own wealth-building portfolio.

When you start building your new portfolio you might find that you are heavily invested in the equity markets, have little cash ready to go, and your asset allocation model is not designed to help you in the next downturn. If that's the case, it's time to create a long-term plan toward optimizing your portfolio.

Of course, that plan isn't going to take shape overnight. You need to make some assumptions about your business's profitability over the next three to five years and consider some long-term decisions about how you're going to redeploy future profits slowly and rebalance your portfolio.

Many entrepreneurs' investment portfolios are so heavily skewed toward the equity markets, they're not protected from potential downturns. In fact, when the next one happens, and it will, not only are these entrepreneurs' businesses at risk, so are their investment portfolios.

Your business is likely your largest asset and a significant portion of your overall net worth. Unfortunately, a business isn't very liquid, so it's even more important to diversify and build a second revenue stream such as, that's right, real estate.

Building wealth takes time, discipline, and patience. Most entrepreneurs grow their wealth through several streams of income, often devoting years to each until it begins to pay dividends. Once the stream produces steady income and is self-sufficient, you can move on to the next one, and then the one after that, and so on. These multiple streams generate cash flow and provide a cushion for when the economy or any of the other streams turn.

I hope that by this point you're ready to kick your old portfolio, and maybe even your financial advisor, to the curb and begin the process of creating a new kickass portfolio. You should be ready to take control of your own invesments, but if you still need an advisor or an accountant for the more complex issues, just make sure you fill them in on your three-buckets strategy and your entrepreneurial status.

If you like what you've read here, by all means, please take a look at my second book coming out in the fall of 2018, *The Kickass Entrepreneur: Small Business Growth Strategies that Will Lead to Triple Sales, Quadruple Profits, and Financial Independence*. Also, you can follow my blog which can be found at www.thekickassentrepreneur.com.

> I hope you've gotten great value from reading this book, and if so, perhaps I can ask you for a favor: if you can spare a couple of minutes, you would really make my month by leaving a quick review of this book on Amazon. If you visit the following URL it will redirect you to the Amazon listing: TheKickAssEntrepreneur.com/BookReview.

As I continue to help entrepreneurs build and scale their businesses, I want to hear about the challenges they're facing and how they've overcome them. I want to know about your successes, your failures, and in what areas you could use the most advice. After my many years as an entrepreneur, I guarantee I can help you find solutions to your problems.

After reading this book you might feel like you know me, but I don't know you, so please don't be a stranger; feel free to reach out and send me an email. It would be my pleasure to hear from you: jeff@jeffwiener.com

Thanks for reading and best of luck to you.

Jeff

About the Author

Jeff Wiener is an entrepreneur who ran a profitable and cash flow positive business for 288 months in-a-row (24 years). During that time, he created an asset allocation strategy that produced a 30% compounded year-on-year return. His business was awarded one of Canada's Fastest Growing Companies, five years in a row. At 49 Jeff stepped down as President of the company, semi-retiring so he can spend time writing and mentoring entrepreneurs. It is his mission to help entrepreneurs grow their businesses and create long-term wealth.

Jeff lives in Toronto, Canada with his wife and college-bound kids, and enjoys spending the cold winter months with his family in South Florida.