David Roberts | M&A Masters Collision Podcast

Host: Patrick Stroth, President of Rubicon Insurance Services

Welcome to M&A Masters, where I speak with the leading experts in mergers and acquisitions. We're all about one thing here: a clean exit for owners, founders, and their investors. Today I'm joined by David Roberts, founder and CEO of Focus Advisors. Focus Advisors is the collision industry's leading M&A advisory firm, helping body shop owners grow and achieve maximum value through a strategic exit.

It is just fantastic and an honor to have you here because you're also a neighbor just across the bay from us. David, welcome to the show today.

Patrick, thank you so much. I appreciate the opportunity to talk with you and to help some of your viewers better understand what we do in our M&A practice here at Focus Advisors.

You are the industry leader for a niche industry, the collision industry, so I can't wait to get your perspective on that field. But before we get into that, let's start with you. What brought you to this point in your career?

Luck, failure, and a wide-ranging curiosity about business. I grew up on the East Coast but was always interested in business. When I came to the West Coast, I had the opportunity to go to law school, business school. When I came out of school, I practiced law for a couple of years, but that just didn't light my fire. So, I took a little detour.

Working my way through school, I had worked as a waiter and a bartender in the restaurant business. I met some good people, and we all said, "Hey, it'd be really great to start some restaurants." Well, I did that for eight years, and that was both a wonderful lesson and a hard lesson because we had some failures and some successes. Ultimately, I decided that wasn't the business I wanted to spend my career in. It's very much a young person's business.

I had a friend in the investment management business who said, "Gosh, you know a lot about different businesses. Why don't you come over here and learn to be an investment analyst?" So, I did. I went to work for a firm here in the Bay Area. For seven years, I was retrained as an investment analyst and portfolio manager. I learned all about the investment community, how Wall Street really works, IPOs, and the entire environment of raising capital, taking companies public, and advising owners on how to invest. That was an incredible journey and an incredible opportunity to learn across a very wide variety of

companies. I probably looked at 500 different IPOs over those years because it was a hot market. You learn a lot about business in general by looking at a wide variety of individual businesses.

A lot of people assume that since you have this niche with collision centers, were you into cars? Were you into mechanical stuff?

I love cars. I had my first car when I was in college. I saved some money, and my first car was a VW van. I did everything from replacing the wheel bearings to taking out the engine and grinding down the valves before reinstalling it. VWs were notoriously underpowered. My next car was a Volvo, and I did the same thing. Then a BMW, and I did the same thing there. So yes, I'm a car guy. And I'm a body shop car guy now. I'm interested in all sorts of things, but when I see a new or interesting vehicle or technology, I'm all over it. When I see new services starting up in the automotive or what we now call the mobility industry, that's what really rings my bell.

That brings you over to Focus Advisors. You didn't name it David Roberts Advisors, so where did the name "Focus" come from?

I was doing a lot of different things when I left the investment firm. I was doing contract research with other folks, working in healthcare, chemical companies, and restaurants—a wide variety. One of the things I recognized about myself was that while I was curious about many things, to get good at something, you've got to get focused. I decided to remind myself every day that I needed to focus.

So I stopped working in drug development and real estate and started concentrating on more specific industries. In the 90s, the healthcare industry was really rapidly changing, and I was fascinated by how the payors, delivery systems, and providers were going to navigate these changes. You know, this is an area I find interesting so why don't I get to know the providers that are in this evolving system. This is when HMOs and PPOs pupping up everywhere. I started talking with doctor groups, rehab companies and nursing homes about the consolidation taking place. And Insurers were the ones paying the bills – slowly! So there was a lot of unhappiness in the healthcare industry.

At the same time, my wife was consulting with large auto insurers on how to be more efficient in settling claims. It was a craft industry back then, with people setting themselves up as experts without using data to settle claims. For a couple of years, I advised her and her colleagues. They put together a specialty adjusting and reinsurance firm to better handle these claims. We raised them serious money, met with a lot auto

insurance experts, and that's when I realized auto insurance was similar to health insurance.

That's nice also because I'm sure, because the autos you know perk your interest a lot more than healthcare. I could see that consistency because when people think healthcare, they think doctors, hospitals, that's it and I would think with auto, well's its a repair shop that's it. That's a key thing is that the payor is the insurance company. Just as healthcare still quite a bit fragmented, I would think the auto collision is absolutely fragmented.

Well, health insurers pay all the providers and auto insurers pay all the providers. (The insureds only pay their deductibles.) Back when I started Caliber Collision Centers of which I was a founder, insurance companies were paying 52,000 body shops and they were negotiating individually with every one of those. Of course, they had a lot of insureds that weren't happy with the idea of "Go out and get three estimates and we'll pay the lowest priced one."

So observing what was going on in the health insurance industry where scale was really driving everything, I said to myself, "Wow, that model is going to come to auto insurance. How do I start a business that can be on the forefront of that change?" So that was my segue into actually being an automotive entrepreneur and entering what happened to be an enormous business.

So you go ahead and become one of the founders of the largest collision networks out there, Caliber Collision. How did you go from there to now being on the other side of the table where you're on a M&A capacity with Focus?

Well let me set the table here about the industry we're in. The auto industry is the second largest industry in the United States, it's $1.6T this year. There's a segment of it called the Aftermarket and it's about $375B. Collision repair which is just glass, body repair, and calibrations is around $55B. This is a huge industry! Twenty-five years ago, there were about 52,000 body shops in the US and not a single one had scale. I'm talking about the biggest body shop in America didn't have $10M in revenue. Totally unconsolidated!

The insurance companies collected all the premiums, but body shops had to find their own customers Conflict was pretty much the order of the day. I decided there had to be a better system. We set out to build a consolidator to provide a much more standard way of doing business and give people better pricing, a better experience and bring scale to the business.

My partners and I looked at each other and said, "Why don't we build a billion dollar business?" We put together a business plan, raised $20 million (which is like $100 million today), and started buying and integrating body shops. We were pretty naive. Insurers just hated us. They resisted, making things difficult, but we focused on acquiring shops in Southern California and then in Texas.

Ten years later, the industry started changing with the creation of direct repair programs (DRPs) , allowing larger and more productive shops to fix cars faster and better. During that time, I served as Chairman and Chief Development Officer of Caliber, helping build a great management team and an M&A process that acquired dozens and dozens of shops. We grew to about $250 million. In 2008, we sold to a big Canadian private equity firm. Five years later, that firm sold it to another private equity firm, and four years later, it was sold again. About six years ago, they merged with one of their biggest competitors, ABRA, and this year, they'll hit about $8 billion in sales.

So having gone through that entire development cycle, I was thinking, you know, I really do know something about the collision repair industry and I'm going to figure out how to continue – you know we did alright starting Caliber but it did even better after we sold it.

In 2008, I returned to M&A, representing clients in raising capital, helping them grow and sell to larger buyers. Initially I was more of a generalist. In 2013, I refocused on the collision repair industry as more capital entered and more transactions took place, most without professional intermediaries.

Well, I think that's one of the big holes out there that you're coming to fill. I always ask, what are you bringing to the table that all these other advisors aren't? I think the legacy you have and the specialization in this niche is unquestioned. You've also been on the other side of the table with other independent owners and founders. What are some other things you bring to table with Focus Advisors that some other larger generalist, larger IB firm may not have at their fingertips?

You know Focus has done most of the represented transactions below $100M in the industry. Hundreds on shops and 100s of millions in revenue. We help do that by creating an industry database and research that helps all the buyers and sellers better understand the whole process. What the values are. What the key terms and conditions that are important to both parties in an M&A transaction. And as you've mentioned, I've sat in every seat around the M&A table - from being the entrepreneur raising money for myself, a buyer buying body shops, a seller to private equity and then being an intermediary.

Appreciating that whole context, we really help our clients understand what's possible and what's not, when to push and when to accept what's offered and how to present the business and how to negotiate, not just the price but all the other terms and conditions of the deal. An experienced intermediary has seen lots of the hiccups that come with the transactions such as disappointing operating results, management changes, loss of customers, you name it. So as an intermediary you've got to understand how to advocate for your client and how to communicate for your clients with potential buyers.

Once we have a signed LOI, we close almost every deal on terms that both parties find acceptable. Sometimes one of our clients will decide, "You know what, it's just not right for me" and we'll say "Hallelujah - you don't have to sell your business we're here with you for the long-term, take a break, come back later" and that's happened multiple times.

There could be a mistaken belief out there that if you've seen one body shop, you've seen them all because they may not vary widely but let's talk about this. Let's talk about the factors what makes a good body shop opportunity versus a bad one. Give me a profile, paint a picture of your ideal client and then you can go into the ins and outs of the collision industry and who the target owners and founders are.

You know, as I've said before, this is a huge industry. There are still 30,000+ body shops out there and the people that are most successful at exiting have scale, they are well-managed, they have above average EBITDA.

Our ideal client is a multi-shop operator (MSO), running two or more shops but our sweet spot is 5 or more with revenues of $10 to $50 million, strong management, low technician turnover, and EBITDA margins around 15%. We help them understand all the challenges of selling a collision repair business. We have had a lot of clients that try to do it on their own and who don't understand the importance of a multi-bidder process to increase value and reduce risk.

I'll give you an example, we're currently going to market with a seller of a 2-shop MSO with $8M revenue. A buyer came out of the blue, "Hey, I'll buy your business. Don't talk to anyone else and here's the price I'll give you." Well, this owner said, "Hey, that's a great deal." and he jumped into an LOI with the buyer and spent 4 months negotiating, defending his quality of earnings and due diligence investigations. And when it was all said and done the buyer cut the price. "You know your EBITDA wasn't even close to what you said it was" and offered a re-trade - down 40% from the original offer.

Oof.

He was more than disappointed, he was angry, he was upset, and he was really discouraged. So he came to us because we had been talking to him for years before his offer. Like a lot of buyers who get an offer out of the blue think to themselves, "Well I don't have to pay any kind of brokerage fee on this. Why don't I do it myself?"

Well, this situation is exactly why sellers use intermediaries like us. For this client,we did a lot deeper due diligence. We wrote up a CIM (Confidential Information Memorandum) that almost doubled his defensible EBITDA from what he presented previously to the buyer. Today, we have 3 prospective buyers and we think he's going to sell for close to the original offer.

Sometimes large buyers come to us saying "We want to buy somebody, and they have an accepted our LOI but we can't get them to get their work done and complete the process. Can you help us?" So we tell these big buyers, "Well, we're going to represent them not you and they're like "okay go ahead, give it your best shot" and we've done that multiple times. We help the sellers navigate this process. We take some of the extreme emotions out of what is always an emotional process for these owners.

Yeah, I think that buffer position you play in the negotiation process I think is absolutely essential and quite frankly these owners are pounding metal and replacing glass, they're not looking at the ins and outs of a transaction so naturally, they're going to be reluctant answering lots and lots of questions.

Well most of the owners we represent haven't pounded metal in a long time or haven't ever pounded because they're smart business people. But what they do is understand the dynamics of working with insurance companies and working with technicians and estimating and organizing and logistics in what is seen by many people as a nuts and bolts business. It's a very technically challenging business with lots of new technology and ways that metal is put together and calibration required for all of these safety and self-driving features. These clients are some of the smartest people I've ever met.

Let's look at how you structure deals. I'm just wondering if there's a big variance in how deals are structured between solo-shop owners and MSOs?

Our sweet spot is representing MSOs although we've done a few single shops, generally larger ones with substantial revenues. This is an industry where almost all the deals are asset purchases. We've only done a couple of stock deals. One of the reasons is because the buyers are well capitalized so they don't want to give out stock because they believe

their stock price is going to go up. Sometimes when a buyer is smaller, they may stock as part of their asset purchase but they never merge companies for stock for stock.

With our clients, our process is to help reconstruct their EBITDA in a clear, defensible way so that they can get through a Quality of Earnings examination with minimal changes. Within the 30 to 40 page CIM, we create an accurate financial picture. This way it helps the deal move along a lot faster. The buyers know a CIM that we've helped prepare is going to be accurate and the detail behind the representations can be examined and the buyers can make more well-informed decisions.

We have a deal right now that has 5 offers and each offer is different because each buyer sees something different in the business. Some want to pay less rent for the real estate, some of them think the technicians aren't going to stick around and they don't want to take that risk. There's so many different variables. But because they got a full disclosure from us, they can make the decision faster. This creates better trust among clients and buyers.

I think one of things that keeps commitment on both sides is that the buyers will impose "clawbacks" or an indemnification provision in the purchase agreement so if that there's something the seller didn't tell them and that miscommunication leads to a loss, the buyers have a way of recovering funds for their loss. A lot of times buyers will assign a percentage holdback like 10% or so. How do your clients handle that?

Well in our industry, a 10% holdback is pretty standard for representations and warranties (promises by the seller what they're saying in their representation is true). You know, not everybody knows for sure what every individual risk is and so they want to protect themselves against that. Often the buyer wants to hold 10% or sometimes more of the purchase price for 6 mos. or a year to make sure it's all true. Sellers often don't want to take that risk, so they buy insurance against (misprepresentations) and that gives the buyer some comfort. They don't have to go after the seller or the funds in escrow for the holdback. We like that and have done a couple of deals like that.

Sometimes, the buyer will say "I'll give you additional consideration on earnouts". That could be 50-70% of the purchase price. We recently took a client to market that got an extraordinary offer. About 40% was in an earnout and both the buyer and seller took insurance on it. The deal didn't close for other reasons. Now that client is going to return to market later this year and we anticipate there will be some rep and warranty insurance on that one.

Regarding the reps and warranty insurance, the seller is making these disclosures to the buyer. The buyer can do as much diligence as they can, but they're not going to know everything. And so they want to have a little carve out that because “we can't know everything, you know, we're gambling millions of dollars that your memory is perfect, and you told us everything you know but we're just going to hold some money back. So we've got some cash right on hand to throw at a problem to which sellers are kind of responding. Wait, I answered all your questions. You can't hold me responsible for something I didn't know about at the time.

So you got the potential friction. And where the insurance industry came and said, “Look, show us the reps between the two parties. If there's a breach of those reps and it costs the buyer financially, don't sue each other. Don't clawback from each other. Come to us under the insurance policy. Show us the breach. Show us the math. You know, if you say it's $1.4 million loss, show us your math and you know, if it checks out, we're going to pay you. The buyer gets a remedy and gets their loss covered, and it doesn't come out of the seller's pocket.

And that question that's come up many times for our sellers is like, well, I've heard about these holdbacks. I don't want them to hold back anything. I want all the proceeds right up front. In the past there weren't alternatives but now the industry has a product. It's called Transaction Liability Private Enterprise, TLPE. It's a rep and warranty policy that is written specifically for deals that are priced under $50 million. It's got to be simple for the industry.

Collision centers are a prime candidate. This isn't life sciences or nuclear energy or anything unique. And for on average, about $15,000 per million dollars in policy limits, the seller can get a policy that will cover from 10% of the purchase price up to a100% of the purchase price in some cases. And so if you've got that policy, there's no need for an escrow or any holdback at all.

The seller can say to the buyer, "Why have an escrow, we have an insurance policy”. The buyer can look at this and say, well, without insurance, I've got a hedge of 10%. I've got 10% of the purchase price that I can hold onto. But if the seller can get an insurance policy that we can insure 50% of the purchase price.”

A lot of our clients sort of reluctantly agree to holdbacks, but they always want it to be zero. But they also recognize they don't know everything about their own business. And so the buyer says, “well, if you don't know everything, I don't know everything either, so I want to be protected.”

So insurance is really one of the ways to bridge that lack of mutual understanding about the risks because at the end of the day the seller thinks, “well, I thought I told you everything.” And the buyer says, “well, I don’t think you told me everything. But let's not argue about it. You got insurance, you already paid up front. We're going to go after the insurance because it turns out that something wasn't true.” It's a good outcome for both parties when insurance is in place because you don't spend your time arguing about stuff.

For example, you could take a $20 million deal. And with a traditional holdback, the buyer has $2 million to reserve. Okay? So the seller, and we're recording this in 2025, has to wait a year or so for $2 million in cash, which in this economy you'd like to have $2 million today to invest and do some other things, but you've got to just hold it there and forgoe other opportunities.

We could write a $5 million limit policy on a $20 million deal for $75 grand, and in a lot of cases, it's very common for the buyer and the seller to share the cost. At that reduced expenditure as a buyer you’ve got two and a half times the protection that you would've had if there were no insurance.

Seller, you get $2 million more cash. Not only do you get that money and close it, you don't have the risk of getting an email one Saturday morning from the buyer saying, there's been a loss. We‘ve got to claw back some more money. That's, that's all gone. And so it is one thing that we like, uh, seeing in the M&A market, this type of insurance is everywhere on a hundred-million-dollar deals.

It’s only recently now that this has become available for deals that are under $50 million, and I think it's just the more people that know about it, I think we're going to have a lot more successful closings that are faster, simpler, and happier, which is kind of how we like it.

Well, it's one of the things that we get to talk to buyers about too, because when a buyer is expressing their skepticism about something, we say, “look, let's just get some insurance on this.”

And we're in what I would say is a more volatile era right now. Things can, you know, change fairly rapidly and you know, you can't absolutely predict the future. So I would expect with more volatility, you'll probably see more and more of this insurance. And it's good to have that tool in our toolbox.

What we're trying to do is get the awareness up.

Now David, you said about 30,000 collision centers are still out there. We're talking in early 2025. What can you tell me trend wise, what do you see going forward either for the industry yourself or for Focus Advisors in in particular?

Consolidation in this industry has been ongoing for 20 years and will continue for another 20. It's only 30% consolidated now. We expect five to eight national players and mnay strong regional competitors. Insurance companies want competition. We expect more manufacturer-owned chains will emerge. Tesla owns 50 shops and plans to expand to several hundred. Dealers own about 5,000 body shops, but many struggle to keep them full. Technology is driving the industry, requiring more capital, better-trained personnel, and strong management, everybody has to raise their game. They're going to need capital. It's an ebb and flow business in M&A.

Let's talk about one thing that's kind of near and dear to my heart is on the labor side, this is pretty skilled labor. And so talk about the issues with the skilled labor. How long does it take for a technician to get there? And you've got constant ongoing evolutions of technology.

Keeping up to speed with your staff is just critical. This industry has been short thousands of technicians for the last 10 years, and it takes three to five years to develop somebody into a class A technician.

And so many people think, oh, this is a dirty business. Its just people banging metal. No, class A technicians, a lot of them in their twenties, make $120 to $200,000 a year. And, you know, they're right up there with other professionals. They make a whole lot more than a teacher. They make a whole lot more than a lot of degree required professionals.

And as the electronics in these vehicles expand exponentially, technicians are really working with computers more than they're working with paint and bending metal. There's a whole segment of our industry called ADAS where computerized calibration is required in almost any vehicle that has had a windshield replaced or any kind of a fender-bender or even their shocks changed. You've got to recalibrate the entire vehicle!

Increasingly small shops can't compete with that. You've got to have more - more revenue, more capital, more skilled technicians.

And right now, they are competing with the big operators who are acquiring hundreds and hundreds of shops every year. Some of the acquisitions are single shops. But the larger consolidators are also opening their own greenfield and brownfield shops. And when a consolidator opens puts a 20,000 square foot shop that's highly certified next to a 12,000

square foot uncertified shop, that small shop is probably not going to do well. And the owner is really going to look at exiting the business. That's like a local store having a Walmart or a Costco open up right across the street. You know, it's really hard as a single shop these days. But people have choices though and one of their choice's is don't wait for that to happen. Join up with some of your competitors and build a bigger business or talk to Focus Advisors and get the process started to consider your options.

David Roberts from Focus Advisors. How can our audience members find you?

We have a team of eight people that help create all these great exit opportunities within our industry. We've got a data team that tracks just about every consolidator, every transaction, every MSO and almost every shop in the US and Canada. And we've got a team of four investment bankers, Chris Lane and Madeline Rich, Raul Salinas, and myself, and we're adding two more this year.

We love helping entrepreneurs who have spent a lifetime building a business realize the benefits of their hard work. If you're considering an exit, you can reach us at www.focusadvisors.com, email me at david.roberts@focusadvisors.com, or call me at (510) 444-1173. Thanks again for having me on today. I truly enjoy talking about our industry and the great people in it.