Selling My Business, My Way

Not all Buyers are Created Equal

By Walt Lipski

Before considering the sale of their business every business owner should answer the WIIFM question: What's In It for Me?

You have heard the old saying, *if you don't know where you are going, any road will take you there.* For a business owner getting ready to sell, this adage might read, **if you don't know what you need out of a transaction, then most any buyer will do.** However, we know this is simply not the case; most business owners would not accept just any consideration or sell to just any buyer.

Before discussing buyer types, let's set the stage from your perspective as the business owner.

First, it's about WIIFM

What personal objectives would be achieved through the sale of your business? Asked another way, what do you, and your family, need out of a transaction to reach your goals and objectives? In the article, Hope is Not an Exit Strategy, we share some suggestions with a two-step process for determining your WIIFM.

Price vs. Value

Understanding the difference between price and value is crucial. **Price** is a number that a buyer is willing to pay to acquire something, in this case a business. The price for a business is usually some multiple of earnings generally expressed as EBITDA (Earnings Before Interest Taxes Depreciation and Amortization). If all deals were done on a cash basis then price and value would be the same, but that is not always how the world works or generally transactions are structured. When we consider the overall effect of price and terms, now we are speaking of **value**.

Simple question: **Would you prefer $7 million dollars paid out over 10 years in a non-guaranteed, subordinated note, paying 4% interest, or $5 million dollars cash today?** The overwhelming majority of people would find the $5 million dollars today to be of greater value to them.

Maximize Value: Choose the buyer who can buy the way you need to sell!

There are basically three types or categories of buyers for a middle market business: Strategic, Financial and Individuals (which could include employees). For our discussion let's describe a middle market business as having annual revenues between $7 and $80 million dollars and EBITDA of $1 to $8 million dollars. Historically, middle market businesses in the manufacturing, distribution and service industries have sold for between 3.5 and 5 times EBITDA. Yet there are instances where these businesses sell for more, much more. This usually happens when one of two things is driving the added value:

1. The related industry is experiencing an exponential growth cycle. Some recent examples include the oil service industry in the Baaken formation, the solar industry a few years back or the housing industry in the last run up. All of these exponential growth situations were temporary and fueled by factors **outside and beyond a business owner's control.**

Or

2. The business is sold to a 'good fit buyer" through a competitive process, causing them to really stretch in both price and terms to acquire the company. **This second way to drive value IS in the control of the business owner.**

Buyer Types: Who is the right Buyer for you?

The Strategic Buyer is an established company in your industry or an allied industry. Strategic buyers often:

- Buy to gain market share, take advantage of synergies between the respective companies or gain a geographic presence.
- Pay a higher price than other types of buyers due to their ability to leverage synergies.
- Seek to purchase 100% of the company.
  - Consideration generally ranges from cash, stock in buying company, earn out and/or a bonus royalty arrangement.
  - Financial leverage is usually limited.
- Merge the acquired company into the acquiring entity (usually resulting in the loss of a 'family business' identity).
- Change or eliminate current management roles post-transition.

Since the Strategic Buyer is in the industry, they have less perceived risk in making the acquisition. However, rigorous care must be exercised to maintain confidentiality and insure the selling company is not harmed. Please see the Case Study below.

The Financial Buyer is generally a Private Equity Fund or other pool of institutional capital. Private Equity Funds generally raise capital from institutions, foundations and very high net worth individuals, to deploy in the acquisition and growth of privately held companies. Over the life of a typical fund, usually 10 years, the purpose is to maximize financial return.

A few characteristics of Private Equity transactions:

- Ownership can vary, although most financial buyers want a majority position with a passive management role.
  - Consideration generally ranges from cash, stock in "NewCo", seller note and possibly an earn-out. Deal structure usually incorporates Financial Leverage.
- Partnership with management is generally sought – often will provide incentives for management participation across many levels.
- Current management roles are usually kept active and long term, and can allow family members to remain involved.
- Focus is on growth and profitability through:
  - Acquisitions
  - Capital for new products or services
  - Expanded marketing
- Patient and flexible deal structures can be used to facilitate
  - Generational or employee buy outs
  - Partnership buy outs
- Offer flexibility for the seller to take some chips off the table today and gain immediate cash, while keeping a minority stake that allows them a "second bite of the apple" when private equity exits the company.

If price is the only goal, Private Equity may not be the highest bidder. However, if value is the goal, based on price and flexibility in the terms and structure being offered to help achieve some of the seller's overall goals and objectives from a transaction, then the Private Equity Buyer may be a serious contender.

The Individual or Employee Buyer will usually have limitations on coming up with the money due to their inability to gain much leverage with bank financing. There are exceptions and instances where employees or an individual with industry experience may gain private equity backing, in which case they take on some of the attributes described above for a Financial Buyer.

Case Study

To better relate to how the right buyer can make a difference in the **value** received by the seller, consider this example about a client's experience. *(Names and some circumstances have been changed to maintain the confidential identities of the parties.)*

Helen, the daughter of a middle market distribution company contacted me and shared that she was running the family business for her mother (Mom) who was in good health and in her early 80s, and that they would like to meet at their accountant's office.

At the meeting with Helen, her Mom, and the accountant, I learned that Helen's father had started the business over forty years ago, and she had been running it for the past seventeen years, since his passing. She had a brother and sister, who owned their own businesses in different fields and were financially independent and completely removed from the operation or management of the business. There were no other family members who expressed an interest in the business.

The family's accountant and attorney, both of whom had been advising the family for over 25 years, suggested that Mom consider selling the business while she was still in good health and the company was experiencing good growth and profitability.

These two advisors feared there would be certain jealousy and discord should Mom pass away with Helen running the business and the other siblings only getting the 'crumbs', so to speak.

This was a substantial business and there was not enough extra cash lying around or life insurance in place to make settling the estate an equitable situation among all the siblings.

At this first meeting, Mom shared with me who she thought would be the best buyer. It just happened to be their main competitor, headquartered locally, and the "gorilla" in their industry over a multi-state area.

What type of buyer would be the best fit? Let's consider what a buyer would need to match up to the seller's expectation:

- They would need to have cash – at 82, Mom was not interested in a promissory note.
- They would need management, as Helen was only willing to work in transition.
- This was a proud family – they wanted top dollar as a tribute to their father's legacy, and their hard work over the years.
- We needed a straightforward transaction without complex terms and conditions, as the family members were engaged in the deal and none were sophisticated sellers or had sold a business before.
- A quick closing process was preferred.

As Paul Harvey would say, *now for the rest of the story*.

Working as their M & A Intermediary we identified their needs and executed a strategy for **finding the right buyer** and **getting the best price**.

- We ran a competitive process targeting a pool of Strategic Buyers.
- The process generated indications of interest from 7 buyers.
- Five of these offers were in a price range the sellers considered fair or in the ballpark.
- Only 3 offers were from buyers could pay all cash – with no financing contingencies.
- Back and forth negotiations between multiple buyers improved the three offers to the point where the sellers felt confident they had a couple of good fallback options.
- Only after establishing a fallback position did we approach the "gorilla" competitor and let them know we were courting other buyers, and ask them to let us know their interest within a few business days.
- They reviewed our confidential offering materials, met with Helen and Mom and responded with an all cash offer, which was 20% greater than the best fallback offer.

The deal closed quickly, Helen worked in transition less than 60 days, and both the seller and buyer achieved their goals and objectives from the transaction. Three years later the buyer had doubled revenues and increased margins from an already successful company.

This case study could have just as easily been about a transaction that favored a Private Equity Group as the best-fit buyer, and in a future article I will share one of those transactions. However, this example highlights some important learning takeaways:

- The client knew what they needed out of a transaction and only strategic buyers who could match those needs were considered.
- Targeting a limited buyer pool delivered greater confidentiality.
- We had a strategy to protect the company from its largest competitor:
  - Staging the buyer outreach.
  - Negotiating a solid fallback position with other good buyers.
  - Only reaching out to our competitor after we had leverage working in our favor.

Not all buyers can buy your business the way you need to sell it. If you are considering selling, it is important for you as a business owner to:

- First understand what you need out of a transaction – **WIIFM.**
- Bring in an **experienced M&A Intermediary** early in the process.
- Determine if the sale of your business will help you **accomplish your objectives.**
- If so, **target the best-fit buyers** – close the deal.
- If not, **use the knowledge gained** to work on your business and get it to the point where it can support a transaction that will ultimately meet your needs.

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