Business Buyers are Savvy Shoppers

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The business sale process is a complex battle for leverage. A seller wants to invite many qualified buyers to the table and position his company to produce strategic value. The experienced professional business buyer has his own arsenal of tools to move the balance of power in his favor. This article examines how Private Equity Groups approach the process and try to stack the odds in their favor.

We preach to our business seller clients the benefits of testing the markets and inviting many qualified buyers to participate in the process. The ultimate goal is to get two or more buyers that recognize the tremendous synergies that the combined companies could realize and produce offers that are not based on a financial multiple, but on a strategic value premium. A financial multiple would be a purchase value something like 4 X EBITDA (basically cash flow) or 70% of annual revenue.

What would produce strategic value? The good news is that this can be created in a number of different ways. The evil "Wall Street stereotype" is to eliminate duplicate functions and save a tremendous amount in payroll expenses. I am not a big fan of this as the reason for doing an M&A deal. Somehow tearing something apart does not represent any particular management imagination or skill. Identifying ways to build value by creating the sum of the parts that far exceeds the inputs is real visionary management.

This strategic value can be created by acquiring a complementary product line that can be added to a strong sales and distribution network. Acquisition targets can provide superior systems, business models, product technology, and management talent that can be leveraged by the new combined company to produce revenues and profits that far exceed the two separate companies.

This sounds easy on paper and makes a lot of sense, but the truth is that most acquisitions fall short of expectations because, integrating all the systems, personnel, culture, locations, customers, etc. is complex. This makes buyers cautious. When buyers get cautious, they revert back to the conservative financial multiple which basically provides a safety net to their investment if the post acquisition synergies are not realized.

We subscribe to a private equity group database which helps us identify likely buyers of our sellers based on searching their investing criteria and identifying their portfolio companies. A surprising discovery I made is that in this particular universe of the largest 3500 private equity groups, they owned a combined 46,000 companies. If you wanted to

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draw any conclusions about business buyer behavior, this would be your group of target subjects.

First conclusion is these guys want to win. Sure it's money, but it is the game and the competition and thrill of the conquest that also drives these serial business acquirers. They think they are the smartest guys in the room (hey check their educational, and job history background) and on paper they may just be. But you only need to have one failed $20 million acquisition to instill some real rigor and financial conservatism into your process. They want to stack the deck to put as much as they can in their favor to make these investments winners.

The first thing they do is look for Warren Buffet type businesses. You know the ones that have a durable competitive advantage, positive cash flow, steady growth rate, loyal customers…… They want to draft Payton Manning coming out of Tennessee - Great start.

The next tenant of their success formula is to take advantage of the large company valuation premium. This is how it works. Their first acquisition into a market space is generally a bigger company, say $25 million in revenue. Let's say that this valve and pump company sells for a 6.1 X EBITDA multiple. They then attempt to make a series of tuck-in acquisitions of a $5 million valve company here and a $4 million pump company there. These smaller companies command a smaller valuation multiple than the large company, say 4 X EBITDA. The day the acquisition is completed, the PEG has already won because the acquired company is now valued at the higher EBITDA multiple of its new parent. They make a series of these investments, grow the company organically as well for 7 years and then sell their $150 million in revenue company to a strategic buyer at an EBITDA multiple of 7.8 X.

These sophisticated buyers are very disciplined in their acquisition process and very seldom stray from the strict EBITDA multiple offer. In order to stick to that discipline, they have to look at a lot of deals. We normally ask our buyers that have signed NDA's and looked at our client, and then withdrew, why they dropped out. We get a lot of different answers, but the top answer is that they were in another deal and would not be able to process both at the same time. Most of these firms invite 50 - 100 potential acquisitions into the top of the funnel for each one that they complete.

So, what they are doing is creating the counterbalance of the leverage we are trying to create by getting lots of potential buyers involved. They have multiple options, so if the price gets too high, they go for easier prey. If the sellers are difficult, they move on. If the financial reporting is shaky and unclear they find a company where it is transparent.

Please don't let me give you the impression that this process is totally by the numbers. There are great companies that will command a premium, but just like buying a luxury automobile, they are still shopping.

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