As published in
PRESIDENT&CEO
For & About Middle Market Executives

Selling Your Company: Which Buyer is Best?

What you need to know about Financial Buyers, Strategic Buyers and the new Hybrid Buyer

A recap of a recent interview between Michael Richmond, Managing Director of The DAK Group and Paul Stukel, Founder of PRESIDENT&CEO Magazine

By Michael Richmond

When business owners decide to sell their company, they have options as to "who" will make the best buyer for their business. Depending on the business owners needs and the motivations of the buyer - will determine, which type of buyer will make the best transaction partner – Financial, Strategic or Hybrid. Here is an overview of each, as well as key considerations to factor in when making a decision.

Financial buyers are primarily PE (Private Equity) funds, venture capital firms, hedge funds, family investment offices and high net worth individuals. Their business is buying companies and selling them at a profit within a certain period of time (approximately 5 years). They typical fund an acquisition with a combination of equity and debt and work with the company's management to improve the company's underlying performance. When it is time to liquefy their investment, they will do this either by selling the company again or if the company is big enough, through an IPO (an Initial Public Offering).

The key motivation for financial buyers is Return on Investment (ROI). They look to maximize their returns through performance improvements and the use of leverage, hence the term leveraged buyout. Their goal is to quickly increase the value of the company beyond the initial purchase price to ensure an acceptable ROI.

Financial buyers will fund a buyout with as little as 20% to maybe 40% equity, and finance the remainder with a combination of bank debt and in some cases, seller notes. Typically, financial buyers like to keep the CEO/Owner and other key management on board and will have them maintain an equity stake in the business. This can be advantageous to a buyer that wants to stay involved in the business and get a second bite at the apple, while taking some money off the table at the initial sale. It also works well for the financial buyer who is dependent on the management team to execute the operating improvements required to advance company performance.

Strategic buyers are typically larger operating companies who make an acquisition for a strategic reason. They look for businesses that can be integrated in and complement their core business to support the acquirer's long-term business plan. In strategic acquisitions, buyers are primarily looking for synergies from combining companies that will reduce costs, increase sales and ultimately improve profitability. It's a long term buy and hold strategy.

A strategic buyer can be a competitor but is equally as likely to be in a complementary business. The acquirer will always be seeking sales and earnings growth, but also may be looking for product, customer or geographic diversification or to upgrade some of its own weaknesses in such areas as technology, equipment, distribution, research & development, personnel, or internal processes.

Paul Stukel mentioned that "Sometimes there are strategic reasons to make an acquisition unrelated to synergies."

He went on to share an example:

"Recently, the owner of a popular Mexican food brand was ready to sell his company, He had two options – 1) sell to a larger food company looking to expand by taking over existing customer relationships in a geography it did not currently have, and integrate the products under the known brand. 2) A food company that was willing to pay a premium to get rid of the seller as an annoying competitor. In this case, it was not the combination that improved the acquirer's sales and profitability, but the closing down of the seller's company that resulted in performance improvements."

We are now seeing better earnings performance, improved confidence in the economy, and a pickup in our M & A business, consistent with the overall industry.

While financial buyers are primarily focused on the financial metrics, sellers have the opportunity to maximize the value of a transaction by getting buyers focused on things beyond the numbers to the total value the company can bring to the acquirer both short term and long term.

As a result, usually a strategic buyer can and will pay more for a business than a financial buyer. Over the last five years about 80% of our transactions have been sales to strategic buyers. While financial buyers were also often in the mix, during the process, the highest valuations and the least risks were in strategic sales.

As mentioned, there are certainly times where selling to a financial buyer would make more sense. For example, it is a great strategy for a seller that wants to: 1) take some money off the table, 2) reduce personal risk 3) take the company to the next level with a financial partner, and believes there is significant upside from a second liquidity event not too far into the future.

A new type of buyer – Strategic/Financial Hybrid.

As the M & A market continues to mature, we have seen a "hybrid" buyer emerge. Hybrids are similar to Private Equity firms in that they are buying companies based on financial metrics with the goal of making a profit on its sale, yet they do not have the same 5 - 7 year horizon. Instead, they tend to "hold" the companies for a much longer period and in this way, can afford to be strategic and financial at the same time.

A leader in this hybrid category is that of the "Family Office", who will own or buy a Platform Company in a certain space. As a financial buyer they want to grow the business, improve the profitability, and yes, ultimately sell it, but they do that by making strategic add-on acquisitions to the platform company.

Hybrids will generally pay a premium compared to financial buyer "purists", if they are bidding on a company in the same space as their platform that will bring synergies and improve the platform's performance through the acquisition.

KEY to Getting TOP Valuation for a Business…Understand the Buyer's Motivation.

An important point for sellers to keep in mind is that the variance in valuations from competing buyers always depends on the motivation of each BUYER! Your company may look the same to you as you meet with each buyer, but it looks very different to them based on different needs and wants. Ascertaining each buyer's motivation is an art that comes with years of experience and if done successfully, will make a huge difference in optimizing the purchase price.

Mid-Market Outlook for 2015 - Why Now is The Right Time to Sell

The past few years have been a gearing up period for mid-market companies to sell.

Sellers have been reluctant and cautious, wanting to wait for a stronger economy and improved earnings.

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2015 could be the banner year for mid-market M&A. Why? Strong key market indicators!

- Baby-boomer owners are looking to retire now
- Low interest rates
- Strategic buyers have record levels of cash they need to use
- Private Equity firms need to start spending money because they need to close their funds.

This is a positive sign, but with a word of caution. Buyers are ready to buy and they have the funds to do so. However, they've just been through five or six tough years and they don't want to repeat past mistakes. As a result, we are seeing much more due diligence and kicking the tires much more carefully to ensure the investments they make are really worth the value they appear to have. As a seller, don't be discouraged by the amount of due diligence a buyer is doing. As long as "the house is in order", you should be able to earn the multiple you deserve, and the extended due diligence shows the buyer is very interested.

Whether a Strategic, Financial or Hybrid buyer is knocking on your door, take the time to entertain the conversation. One thing you don't want is for 2016 to roll around and have you be thinking, "I wish I had sold in 2015".

Michael Richmond *is a managing director of The DAK Group, an investment bank specializing in middle-market, privately-held companies, advising business owners on sell-side and buy-side transactions, financial restructuring, capital advisory and valuations & fairness opinions. Email Mike at mrichmond@dakgroup.com.*

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