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What you should do when PE firm offers to buy your business: Part 2

If you own a successful privately held business, then it is likely you have received a call from a private equity firm telling you that they have specifically targeted you and want to buy your business. You have heard now is a good or even great time to sell. The price they offer seems reasonable or even good. They tell you that they pay cash and can get it done quietly. "It will be quick, easy and fast. No need to shop the deal or talk to your lawyer, of course. We do this all of the time." What should you do?

Over the course of three articles, we will offer nine tips on how to navigate these situations. In Part 1, we explained what you can do after the offer is received. In Part 2, we'll explain how to educate yourself about the business market. Part 3 is available here.

4. Understand the market of buying and selling businesses; interest rates, etc.

Your private equity buyer has done their homework and now you will need to become as smart as they are on the market conditions for businesses like yours. Investigate other similarly-sized businesses or business in your geographic market that have been sold recently. Private equity firms often value a business like yours based on a multiple of its past or projected earnings or cash flow. Understand what are likely multiples of EBITDA (earnings before interest, taxes and depreciation, a common cash flow measure) or revenue being paid for businesses of your size in your industry. Often more valuable companies or those with greater growth prospects sell for greater multiples.

Understand that businesses that sell a product with a low marginal cost, like software, may sell for much higher multiples than businesses that offer services. Consider multiples over a period of time. Are they generally increasing or decreasing and what are the reasons behind such changes? Interest rates impact business differently, For example, some businesses need large amounts of capital to be reinvested to continue growing their revenue and profitability. Consider whether there are other trends in your industry which deviate from theses broader trends.

Part of the value any savvy investment banker can provide is they often have deep expertise in certain industries and know many of the acquirers directly as they invest time dealing with these acquirers. These bankers often have a treasure trove of data (including proprietary, non-public data) related to transactions that have and have not closed. Often in interviewing an investment bank they will share some of that market data with you for free to demonstrate their success and knowledge. This industry data is key to any negotiation and you should assume that your private equity buyer has an initial advantage in that respect.

5. Market position messaging

How is your company positioned in the marketplace? Your customer base may be perfectly diversified, but perhaps you are overly reliant on a supplier. You should also put yourself in your buyer's position and examine the marketplace for sale of companies. How does your company compete against similar businesses this private equity might be evaluating? Often these buyers target an industry and contact many businesses in an effort to close an acquisition in that industry. You may be competing in this marketplace already. Make a case for why your buyer should not just go offer or close on a deal based on a similar multiple with one of your competitors. Also be aware of what disadvantages you might have in this respect–items that decrease value and need to be remedied–and fix them before the process begins, if possible.

6. Concentrate on areas of maximum value

Remember that private equity firms see and review an abundance of deals, not just those they try to create themselves. It is easy for them to characterize your business like another one they acquired but stress that yours is less profitable, smaller, or not as geographically diverse. This is intellectually lazy. This simplification or bias can make it easier to explain to their lenders, their partners or even themselves why they would pay a maximum price for your company. Therefore, your business may be more valuable to them the more your business looks like others they have acquired and the less “new” or “different” features your business has.

Any good private equity firm knows what drives value and focuses on those specific business elements. For you, this may mean growth in revenue or profitability. It could mean the diversification of customers or an exceptional management team. There may be a specific customer or customers, unique patented or protected technology or certain strategic relationships. To drive exceptional value you need to identify those areas in your own business, highlight those items in discussions with your potential buyer and you need to be prepared to do it again and again.

The last in the series of articles will focus on general housekeeping after a deal is closed.

David J. Kaufman and Nathan Viehl are members of Thompson Coburn’s Corporate Finance & Securities practice.

authorsTest

david

David J. Kaufman

nathan

Nathan O. Viehl