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Dissecting the Buyer's Pitch

Prospective acquirers are selling you on selling to them. Here's how to think about what they're telling you.

by David Working

Nearly every business owner has heard a pitch to acquire his business. Some pitches are invited, some are not; some are delivered in a boardroom backed by a 150-page slide deck, some are delivered over casual cocktails. Most are honest. All are artfully designed to act in the prospective buyer's best interests. Having been on both sides of hundreds of these pitches, we think it can be instructive for a business owner to understand the why behind what's being said.

Negotiating to try to acquire part or all of a business is fascinating and complex. There's tremendous value to a buyer in maintaining a healthy relationship with the seller after the transaction has closed, especially if the seller will retain a minority stake. It does not benefit the buyer to negotiate away the strength of the relationship to capture the last marginal dollar of price or terms in the transaction. At the very same time, the lower the buyer can push the purchase price, the more room exists to generate returns on the invested capital. Managing the competition between these two forces drives much of a buyer's approach to an owner – how to maximize goodwill in the ongoing relationship while minimizing purchase price.

The dynamic of a competitive auction on a tight timeline is that it forces a group of buyers to come to the table with their very best offers. The difference between a buyer's "fair" offer, delivered without competition, and their "best" offer can be significant.

With that framework in mind, let's examine a few common pitch elements.

EARLY EXCLUSIVITY

An owner might hear a buyer propose that the owner work exclusively with that buyer. The buyer might argue for a "focused process with a single counterparty," the benefit to the seller being "a quiet, confidential process," or "increased speed to close," or "avoiding the headache of an auction." While there can be truth to each of these arguments, the key driver is that the buyer is trying to avoid a competitive auction process.

The dynamic of a competitive auction on a tight timeline is that it forces a group of buyers to come to the table with their very best offers. The difference between a buyer's "fair" offer, delivered without competition, and their "best" offer can be significant. There's a reason many private equity firms, in conversations with their limited partners, like to showcase their proportion of deals that that are "proprietary" (or "off-market" or "unbanked") instead of coming from "intermediaries" (usually investment bankers). The implication is that deals sourced outside of a competitive process offer the private equity firm an opportunity to invest at some discount, which is accretive to returns.

This is not to say that avoiding competitive processes is an underhanded tactic, or automatically results in lowball offers. There are investors who believe their value to the seller is best realized through a relationship developed over time, and there are sellers who won't get comfortable with bringing on a partner over a short timeframe. But an owner should recognize that absent other considerations, an exclusive process is primarily a way for buyers to avoid competition.

COMMON OWNERSHIP

An owner might hear a buyer invite a seller to maintain a minority stake in the business, or "rollover." This can sound like "wanting to have aligned incentives post-close," or "keeping some skin in the game," or realizing economic benefit at the next sale through "a second bite of the apple." This one is tricky – from some buyers, these are truthful points that should be taken at face value; from others, it indicates an attempt to manage the size of the equity check.

There are many reasons why an equity investor may want to shrink the check size. It can be a way to make a few more investments out of a closed fund, or it can be a way to make an investment in a larger business without allocating an outsized proportion of available capital. If an equity investor doesn't have a captive fund, then it may be a way to keep the fundraising process manageable. Some investors will structure their investments as preferred to the owner's rolled equity – this is a way for the investor to improve the risk profile for its own invested capital.

A seller can recognize specific elements of a pitch for what they are: true statements made about the parties or the transaction process that are framed in such a way as to benefit the buyer.

As noted, wanting an owner—ostensibly the most knowledgeable person in the business—to be aligned with the new ownership is perfectly reasonable, and rollover can be an effective mechanism for creating alignment. But when rollover is expected without further discussion around the seller's ongoing role, then it's a fair bet that the rollover is being used

(continued p. 2)

as another source of equity in the transaction to accomplish another purpose for the buyer.

POST-TRANSACTION VALUE CREATION

Buyers often try to differentiate themselves by articulating their abilities, drawing focus away from the transaction itself. A seller might hear how a buyer is "hands-on" or can "draw on operating partners / industry experience / other portfolio companies," or simply hear that "our advice is valuable." These can absolutely be true statements, but it is also true that a buyer who can convince a seller of meaningful post-transaction value can win the deal with less total value at close.

For a seller retaining a minority interest in the post-transaction capital structure, the operational and strategic value brought to the table by a buyer can overwhelm the economics at transaction time, so this is hardly a minor consideration. But buyers can claim to create value much more easily than actually delivering it. A buyer with a demonstrated history of value creation in its investments will have reams of case studies, well-documented playbooks, a specific strategic plan for this opportunity, and an identified team with specific roles and responsibilities to share with a seller. The devil is in the details, and the details are a way for a seller to determine the depth to which a buyer is demonstrating expertise when it comes to value creation post-close.

CONCLUSION

As stated previously, our experience has been that most pitches are made in good faith, by honest businesspeople looking to make a fair deal. A seller can recognize specific elements of a pitch for what they are: true statements made about the parties or the transaction process that are framed in such a way as to benefit the buyer. In doing so, a seller can better understand a buyer's position and motives, and ultimately bring to light the pitch that brings the ***seller*** the most value. **ZS**

ZacharyScott

1200 Fifth Avenue, Suite 1500
Seattle, Washington 98101
ZacharyScott.com

ABOUT ZACHARY SCOTT

Since 1991, Zachary Scott has assisted owners of privately-held businesses in the greater Pacific Northwest to plan and execute major business or ownership transitions by offering sell-side M&A and acquisition and investment advice. For more information on Zachary Scott, go to **ZacharyScott.com.**

Ben Adams
206.838.5526
badams@zacharyscott.com

Brian Bergsagel
206.838.5527
bbergsagel@zacharyscott.com

Frank Buhler
206.224.7383
fbuhler@zacharyscott.com

David Goldstone
206.838.5521
dgoldstone@zacharyscott.com

William Hanneman
206.224.7381
bhanneman@zacharyscott.com

Ray Rezab
206.224.7386
rrezab@zacharyscott.com

Jay Schembs
206.838.5524
jschembs@zacharyscott.com

David Working
206.224.7850
dworking@zacharyscott.com

Mark Working
206.224.7382
mworking@zacharyscott.com