Zachary Scott
INVESTMENT BANKERS

IN$IGHT REPRINT
PERSPECTIVES ON THE CAPITAL MARKETS
SUMMER 2012

The Unsolicited Purchase Offer: What to Do?

Don't let the buyer corner you into making a bad sale.

by William S. Hanneman

Many business owners routinely receive unsolicited calls and letters suggesting an interest in buying their business. Some are real; most are not. Every once in a while, a recognizable industry giant or a well-respected private equity firm approaches a business owner with a sincere interest in acquiring the business. When that event coincides with thoughts an owner harbors about a changing personal situation or a changing industry environment, it can strike a chord.

Receiving an intentioned, well-articulated proposal from a capable and motivated buyer can be quite flattering. The possibility of closing the sale without engaging an investment banker to run a lengthy marketing process has appeal both to the seller and, most certainly, to the buyer.

Although it won't become clear to the business owner until well into the process, such an arrangement generally results in a substandard solution. Before locking on to a single buyer, a business owner should consider that:

I: A great offer is not always the best offer

Buyers rarely put forward their best offer first. A specific business purpose formed the rationale for the initial approach, which generally means the business could be worth more to the buyer than it is on a stand-alone basis. Without expert advice and/or in a competitive process, the seller will never know how far the deal was from the best offer. Our experience has been that the mere threat of a competitive process generally compels a buyer to boost its offer.

II: Exclusive buyers rarely raise their price, and often lower it

A business owner who prematurely commits to a single buyer forfeits nearly all negotiating power to that buyer. The standard protocol in a sale of a business calls for the buyer to put forward a letter of intent. The letter portends to outline the business terms and conditions of a transaction. However, the only binding provision of the letter is exclusivity. This prohibits the seller from sharing information with, soliciting, or entertaining any other offer during the exclusivity period.

A business owner who does not seek expert advice to examine a proposed purchase offer may sell at an undervalued price.

Signing that letter formally passes negotiating leverage to the buyer.

At the time the letter is signed, buyers generally have performed a minimum amount of due diligence to confirm their conclusions of value. A diligence process takes time and costs money and buyers resist investing in advance of exclusivity if they don't have to.

With exclusivity confirmed, no stone that may hide a purchase price reduction will be left unturned. Buyers often engage outside professionals to do this bidding for them, including accountants, lawyers, engineers, industry experts, and environmental consultants.

With exclusivity confirmed, no stone that may hide a purchase price reduction will be left unturned. Buyers often engage outside professionals to do this bidding for them, including accountants, lawyers, engineers, industry experts, and environmental consultants. While generally well meaning, every professional attempts to add value to the process (purchase price reduction > professional fees). That only becomes apparent later.

III: Focusing on an individual buyer does not save time

While a seller may avoid the process of creating a formal selling memorandum, the business owner must still gather all of the information that goes into a memorandum. Buyers don't shortcut a thorough due diligence process, especially with no pressure to do so. In fact, without fear of another buyer waiting in the wings, the diligence investigation proceeds more thoroughly and leisurely.

The process of gathering and evaluating the information necessary to prepare for a sales process not only saves time, but also provides the opportunity to discover business shortcomings, documentation discrepancies, or contingent liabilities prior to a buyer discovering them first and using that to their advantage when the negotiating leverage is in their favor.

IV: Focusing on a single buyer doesn't ensure confidentiality

While working with a single buyer may seem to minimize the chances of the word getting out, the opposite holds true. Because information hasn't been prepared in advance, the buyer often needs to talk to, or gather information from, employees, suppliers and/or customers. This can be particularly problematic if the buyer is a competitor as proprietary data can be compromised before a deal is certain to close.

V: Lack of an intermediary puts the business owner directly in the hot seat

Buyers typically have the advantage. Not only do they typically have more experience buying than the business owner has selling, but they alone will decide when to part with their money. The transaction closes when the buyer writes the check, not a moment before.

Buyers understand that the longer exclusive negotiations go on, the more likely they are to get their way. As time passes, it gets in-

(continued p.2)

creasingly difficult for the seller to turn away from the deal. During those final minutes of the game a tremendous amount of yardage can be lost. Even with the best advisors at the seller's side, the only effective defense is maintaining the threat of alternatives.

The sale of a business requires the business owner to make literally hundreds of important decisions before closing. All involve business issues and affect the economic outcome to the seller. Involving an intermediary fluent in all aspects of a transaction and the dynamics of negotiation provides the seller with flexibility to consider decisions being made and to make corrections if required. Rather than the seller being the "bad guy", the intermediary can play that role, allowing the seller to remain on favorable terms, which is particularly important if buyer and seller intend to work together after closing.

On numerous occasions, Zachary Scott has assisted its clients in closing transactions at much higher prices than the original of-

Buyers typically have the advantage. Not only do they typically have more experience buying than the business owner has selling, but they alone will decide when to part with their money. The transaction closes when the buyer writes the check, not a moment before.

fer. On one occasion, a local specialty food company received an unsolicited offer from a large, publicly traded food company. It was the most logical buyer for the business and the initial offer was fair. However, rather than accept the offer, the specialty food company asked us to draft an offering memorandum and go to market. After seeing the memorandum and understanding that other prospective buyers were being considered, the initial buyer increased its bid by more than 50% in order to quickly close the acquisition.

CONCLUSION

It is tempting to pursue an offer from a legitimate buyer in isolation. Indeed, that's just the way they like it, cornering all of the negotiating leverage for themselves. However, simply starting a formal sale process in a convincing manner is likely to drive the initial bidder's price up significantly. This move will not drive them away. If it did, it is unlikely that the buyer would have stuck with it to the end anyway.

Always operating the business as if it were for sale and maintaining an active relationship with an investment bank enables a firm to launch a competitive process expeditiously in response to an unsolicited offer. ❖

Zachary Scott

INVESTMENT BANKERS

1200 Fifth Avenue, Suite 1500
Seattle, Washington 98101

www.ZacharyScott.com

ABOUT ZACHARY SCOTT

Zachary Scott is an investment banking and financial advisory firm founded in 1991 to serve the needs of privately held, middle-market companies. The firm offers a unique combination of in-depth knowledge of the capital markets and industry competitive dynamics, sophisticated analytical capabilities, and proven expertise in structuring and negotiating complex transactions. For more information on Zachary Scott, please go to ZacharyScott.com.

Mark D. Working
206.224.7382
mworking@zacharyscott.com

William S. Hanneman
206.224.7381
bhanneman@zacharyscott.com

Frank S. Buhler
206.224.7383
fbuhler@zacharyscott.com

Michael T. Newsome
206.224.7387
mnewsome@zacharyscott.com

Ray D. Rezab
206.224.7386
rrezab@zacharyscott.com

Doug Cooper
206.224.7388
dcooper@zacharyscott.com

Jay Schembs
206.838.5524
jschembs@zacharyscott.com

Michael J. Black
206.838.5526
mblack@zacharyscott.com