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How to Prepare for Different Types of Buyers

There is a difference between financial and strategic buyers.

by William S. Hanneman

Owners of businesses should understand that selling to a buyer with a financial orientation would be quite a different experience than selling to one that is pursuing a strategic objective. Understanding those differences in both perspective and process will greatly improve the probability of achieving expectations.

The difference between a financial and strategic buyer is rather simple. A financial buyer views the target business as a standalone entity that has its own life and future prospects based on the company's market position and the strategic direction established by existing management. A strategic buyer views the same business as having certain attributes that can fit into its already established strategy and infrastructure (usually an established business). In essence, the strategic buyer views the target business as a collection of ingredients while a financial buyer sees a finished product.

It is commonly thought that financial buyers are synonymous with private equity firms and only business corporations are strategic in nature.While that used to be a valid distinction, the lines have been blurred as private equity has expanded its ownership of corporate America. Today, a private equity fund invested in a current portfolio company may well be a strategic buyer. Similarly, companies pursuing conglomerate growth strategies will act much like financial buyers.

IT'S A MATTER OF PERSPECTIVE

Strategic buyers have specific views on the best strategy to succeed within their industry. They already possess a particular collection of assets, customers, supply relationships, and management from which they have developed a unique view of the future. That knowledge allows them to view the attributes of a target business and determine quickly how those attributes can be integrated with what they already possess to create a stronger, more profitable business. Change is a common theme. Strategic buyers believe that they can either create revenue enhancements or reduce costs (or both) as a result of integrating the target's assets and capabilities. The intention to integrate the two businesses means that the strategic buyer needs to own 100% of the target business.

Because financial buyers bring only their money to the equation, there is no integration to consider. They view the business as a standalone enterprise. Financial buyers often have no industry strategy framework from which to evaluate the target business. Gaining that perspective is essential prior to making a determination of interest. That can take time. Rather than change, financial buyers desire stability, which can lead to a transaction where less than 100% of the business is purchased in order to create an incentive for continuity of management and employees.

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TRANSACTIONS ARE APPROACHED DIFFERENTLY

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Value A strategic buyer evaluates a target business based on what the acquired assets can contribute to its existing business strategy. Oftentimes, the value of the seller's assets in the hands of the strategic buyer will be worth more than the same assets in the hands of the seller or a financial investor. What the strategic buyer will ultimately pay depends upon a number of factors, including its assessment of the cost to independently build the asset or capability ("build vs. buy"), and the implication to its competitive position if the opportunity is lost to a competitor.

If the strategic buyer is a public company, an additional constraint can raise its head. Public entities are always sensitive to earnings-per-share. Most strategic buyers will not make an offer that will cause earnings-per-share dilution in the long run.

Due Diligence and Timing Because they already operate in the industry, strategic buyers are already knowledgeable about the current trends and the competitive environment. As such, they will spend the bulk of their due diligence effort on verifying the specific attributes of the target and how the pieces would be integrated.

Financial buyers use the due diligence process to first confirm the desirability of the industry, and then the business. Because the entirety of the enterprise is the target, they are highly concerned about understanding everything about the entire "machine." It is quite typical for financial buyers to engage outside professionals to assist with conducting a comprehensive business review, market studies, a quality of earnings assessment, and background checks on key managers. Transferability of all assets, employees, and relationships are paramount. Making sure "everyone" is on the same page after closing is essential. This can be laborious and time consuming.

Making acquisitions is a core competency of financial buyers. So, once a decision to acquire has been made, financial buyers can often move faster. As a result, they follow a well-worn playbook to evaluate, finance, and close acquisitions. Strategic buyers tend to have slow internal processes. They may not have a dedicated merger and acquisition team and may be encumbered by slow-moving boards of directors and investment committees. Many set annual budgets for investments and may need to secure extra resources or delay their

(continued p.2)

bids to the next budget cycle.

Given this difference in timing, if including both financial and strategic buyers in the process, it makes sense to give financial buyers a head start. And, because the probability of closing with a financial buyer tends to be lower than with a strategic buyer, choose an advisor that understands the profiles and styles of the different parties.

THINK ABOUT THE DIFFERENCES BEFORE STARTING

The best advice that can be given is to know the audience and design a sales process accordingly. When positioning a business for sale, different types of buyers require different positioning strategies. Therefore, the thrust of materials, conversations, presentations, and timing should be very different depending on the audience.

Financial buyers need to be schooled on the comprehensive macro view of the industry and the micro view of how the target company competes within that framework. Particularly key is a clear articulation of how the company is going to grow its revenue and free cash flow. Management should be showcased; back office and operational capabilities must be emphasized.

Each strategic buyer should be viewed separately. Discussions and presentations should be focused on the uniqueness of the target company's attributes and how the financial performance will change if the company is combined with the suitor's business, assets and capabilities.

Given that different types of buyers make decisions on different schedules and processes, it makes sense to accommodate those differences in the process so that all will be ready to commit simultaneously.

In most cases, it makes sense to consider both types of buyers. By evaluating both alternatives simultaneously business owners can make the best decision for themselves and the company. ❖

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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.

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