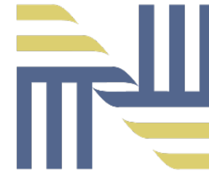

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BEFORE YOU SELL YOUR BUSINESS, THINK LIKE A BUYER

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Introduction

Selling a business (asset or company) should not be difficult. All a seller is ordinarily required to do is to deliver the business in exchange for payment. But this is not really the case for a seller in a Merger & Acquisition (M&A) transaction. The M&A sale process is complex and time consuming, thereby requiring careful planning and strategy. In fact, it is common knowledge that a sale could fall through at any stage before the deal is closed. And even after a deal is closed, the seller will need to meet completion requirements before the purchase consideration will be fully paid. In some cases, even after completion, purchase consideration may be deferred to a later date or clawed back by the buyer in peculiar circumstances.

The primary rationale for selling a business in almost all cases is to receive value (cash) for the investments made in that business. There may be other secondary or even primary reasons for selling. Possible sale rationales have been discussed in a previous article – *'The "Why" Behind Mergers and Acquisitions' (The Why for M&As).* The focus of this paper is how to sell in order to obtain the best possible value –; not 'why' you are selling.

The selling process and why it could impact sale value

Donald Depamphilis (2019, 10th Ed.), suggests that the selling process adopted by the seller determines how much value the seller can realise from the sale. The selling process is often determined by a number of factors such as (a) the nature of the industry in which Target (the business to be sold) operates – for instance, how one chooses to sell a start-up tech company may differ from how a global tech giant is sold; (b) the kind of buyers the seller is looking to attract; (c) the size of the Target or seller in the industry (the selling process considerations for MTN Nigeria for instance will be very different from that of Smile Communications given the difference in their market size, regulatory concerns and potential buyers); and so on.

Depamphilis identifies three broad selling processes. There may be more processes such as court sanctioned schemes of arrangement. However, this paper will discuss just the three identified by Depamphilis. They are:

a. Public Auction

A seller may decide to sell a Target by way of auction (also referred to as *'fashion parade'* in the deal community). Tom Speechley (*Acquisition Finance, 2015*) states that auctions afford the seller the chance to have more buyers compete for the Target thereby obtaining the fullest market price available. Buyers will be ranked by seller according to the size of their

bids, their proposed form of payment, the ability of the buyer to finance the transaction, the perceived ease of doing a deal and sometimes, post-deal integration considerations. Sale by public auctions mean that the seller announces that it is putting the Target up for sale and is inviting interested buyers to bid. This sale process is best suited to – in Depamphilis's words – "*small, private, or hard-to-value Targets*". It is also suited for tech start-ups playing in industries where there are dominant tech companies. The announcement of an intention to sell will put the industry giants on notice to either buy the start-up or risk a competitor buying it. For instance, Facebook's $1billion dollar takeover of Instagram was partly inspired by the need to avoid it being bought by competition. Hence, by understanding the motivation of a potential buyer, a seller could obtain optimal value by positioning itself to take advantage of competitive rivalry amongst buyers.

Public auctions are not without their disadvantages. Significant time and cost may be lost/incurred in evaluating a lot of unqualified bids. Also, the initial stage of the transaction is overly laborious because of the large preliminary due diligence (DD) on Target from bidders that may not qualify. Most importantly, releasing DD documents and information to lots of bidders makes the Target's and seller's information public knowledge of some sort, notwithstanding the confidentiality obligations in the preliminary documentation. Such information may confer competitive advantage on seller's competitors. These disadvantages should be considered side by side with the benefits of undertaking the public auction selling process.

b. Controlled Auction

As the name suggests, this is an auction where only select bidders are invited. Imagine that diamonds are to be sold by auction. A public announcement will not be made. Only select bidders, usually from a prequalified list, will be notified and/or invited.

In the controlled auction selling process, the seller may be concerned about the quality of potential buyers it attracts and will therefore create a list of potential strategic and/or financial buyers for the Target. The seller then invites these potential buyers to bid for Target thereby igniting competition amongst them. The advantage of this sale process is that seller spends less time and cost in entertaining unserious bids. Also, the risk of seller/Target information being made public is curtailed.

Controlled auctions are appropriate in situations where seller is relatively large and seeks to avoid value diluting public auctions; is concerned about the handling of its proprietary information; or both. For instance, Pfizer's sale of its baby food business in 2012 was organised by way of controlled auction involving Nestle and Groupe Danone. Nestle eventually won the bid and purchased the business for $11.85 billion. Also, Squid Soap's sale to Airborne in 2007 for $27.5 million ($1million in cash and $26.5million in earnouts) was concluded off the back of what seems to be a controlled auction involving Procter and Gamble, among other buyers.

A seller who chooses the controlled auction option understands how competition amongst bidders will result in a higher sale price, but is also mindful of the disadvantages of public auctions. Controlled auction is therefore a bit hybrid. Its main disadvantage is that potential good buyers may be excluded in the seller's list.

c. Exclusive/One-on One Negotiations

This by far the most common selling process in M&A transactions. This process involves a buyer approaching a seller to negotiate the sale of the Target (buyer-initiated), or a seller approaching a buyer to negotiate the sale of the Target to the buyer (seller-initiated). A typical example of seller-initiated one-on-one sale is Google's sale of its *Motorola Mobility smartphone business* to Lenovo in 2014. In this case, Google called Lenovo to offer Motorola Mobility for sale. In Google's case, offering Motorola to its preferred buyer was purely strategic. However, this borders on the 'why' and will not be addressed in this paper (please see The Why for M&As for an extensive discussion on the Google-Lenovo deal). Depamphilis (2019) posits that approximately one-half of all M&A transactions are done through one-on-one negotiations and about 20% of all M&A transactions are seller-initiated.

The exclusive sale process is suitable for sellers in certain key industries where public knowledge of sale of Target may create systemic disruption or where auctions are undesirable in view of the need to protect the proprietary information of the seller. For instance, the sale of Diamond Bank to Access Bank in Nigeria was negotiated on a one-on-one and highly confidential basis such that while the deal was underway, parties continued to be discreet as to whether any deal was being discussed. Imagine what would have happened if Diamond Bank had carried out an auction and word got out that it was being offered for sale. Banking customers may have, out of fear for bank collapse and loss of deposits, withdrawn their funds, not just from Diamond Bank, but also from other banks rumoured to be weak. Such panic withdrawals could destabilise the banking ecosystem.

Also, imagine that Paystack, the Nigerian payment services provider that was recently acquired by Stripe, was to be on-sold by Stripe. Absent any regulatory restrictions, it will likely prefer to enter into discussions on an exclusive basis and based on synergistic considerations, to avoid uncontrolled competitors getting access to its business secrets or conducting technical DD on its payment systems. This is because the highly proprietary nature of its business requires such discreet management that makes auctions undesirable. Essentially, barring any regulatory restrictions, the nature of business and the quality of buyers seller looks to attract should inform whether an exclusive sale process is best.

A disadvantage of the exclusive sale process is that it may not take potential attractive purchasers, who may pay more, into consideration.

Type of buyer and why it matters for the seller in obtaining good sale value

Buyers are generally categorised as strategic or financial. Strategic buyers are those who buy because they believe that the Target fits with their overall strategic plan. Financial buyers are those who buy for purely financial reasons (e.g., Private Equity firms) – to revamp and resell the Target for a desired Rate of Return (RoR). Thus, where for instance seller intends to sell only a portion of Target it is likely to prefer only strategic buyers who will add sustainable long-term value that will in turn improve the value of seller's unsold stake. Where on the other hand, seller is divesting completely, it may matter less to it whether the buyer is strategic or financial unless there are reputational considerations. Hence, seller motivations should inform the

type of buyer that the seller looks to attract; this will in turn, inform the seller's positioning for a valuable sale.

According to Depamphilis, research suggests that strategic buyers are likely to pay a higher amount for Targets. However, this payment may come in a combination of shares and cash, or other in-kind and deferred payments. Thus, where the seller is primarily interested in receiving full cash for the Target, a financial buyer may be preferred.

Discussions around the type of buyer is also important for sellers because the requirements for the relevant transaction may be shaped by the type of buyer. For example, most financial buyers purchase businesses by way of buyouts. In a buy-out, the financial sponsor – the Private Equity Firm – leads the purchase and provides the equity component of the funding for the purchase price. However, because the equity component of the funding will not be sufficient, it approaches a bank or other institutional financier to provide what is called 'Acquisition or Bid Finance' in order to fund the remainder of the purchase price. This loan is provided specifically for the purpose of funding the purchase and is given on a non-recourse basis. (NB: non-recourse means that in the event of failure of the loan, the lender will not have recourse to the Private Equity Firm but will have recourse to the Target purchased with the loan.)

Why should this matter to a seller who merely seeks to obtain sale value? The reason is that any lender who wants to provide non-recourse funding for such an acquisition would want to be convinced on the viability of the acquisition by scrutinising the relevant documentation maintained by the Target, such as business plan, financial forecast, and so on. So, where the seller is short on documentation, buyer may find it difficult to raise funding to meet seller's asking price thereby affecting seller's ability to obtain the desired value.

On the other hand, a strategic buyer (in most cases a corporate acquirer/bidder) is driven by synergistic purposes. This means that its primary consideration is how the Target can add value to its existing business. Thus, to obtain higher sale value, the seller should take care to highlight those aspects of the business which will deliver the desired synergy to the buyer. This is not to say that a corporate acquirer has no need for debt finance like the Private Equity Firm in a buy-out. Indeed, a corporate purchaser may resort to debt financing. However, this financing is obtained on the strength of the buyer's balance sheet, and on a recourse basis, meaning that the corporate purchaser is responsible for repayment and not the Target. Hence, the financier may care less about the Target's business viability, thereby allowing the corporate buyer to obtain full financing and meet the seller's asking price as long as the synergy is right.

Thinking like a buyer in order to obtain maximum value – a case for the EOTB analysis.

Imagine that you head a Private Equity Fund and have personally overseen the purchase of over 20 businesses. If you decide to sell any of such businesses, will you have any difficulty in identifying what a buyer will be on the lookout for in order to obtain maximum value from such sale? Will you not prepare the business as though you were a buyer yourself in order to ensure an almost hassle-free sale and for good value? This is what it means to sell with a buyer mindset. A good seller will put itself in the buyer's shoes and anticipate who its potential buyers are, what their buying motivations are

and what they may be on the lookout for. These considerations will enable the seller to better prepare for a sale and to have an estimation of how much value it could receive for the Target.

Andrew Sherman (2018) highlights the need for the seller to conduct a strategic 'Eyes Of The Buyer' (EOTB) analysis. EOTB is an analysis which gets the seller to stand in the buyer's shoes and ask itself critical questions that will position it (the seller) for sale. The seller should proceed with the following questions as suggested partly by Sherman and partly by Chike Obimma:

- Why are we selling?
- What category of buyers (strategic or financial) are we looking for, considering why we are selling and what our post-sale plans are?
- How does Target add value to the buyers' business model?
- Will the sale be synergistic for potential buyers and how can Target strengthen the buyers' core capabilities or revenue streams?
- What sale process best suits why we are selling and our post-sale plans?
- Is Target up to date with its corporate and business documentation as well as regulatory filings and compliance?
- Are there value-diminishing factors which may make the Target undesirable or reduce its price – for instance, tax liabilities, unresolved/potentially costly litigation, or even large trade payables for goods which cannot be accounted for or which do not command good market value?
- Are there industry specific considerations that buyers may be concerned about, such as compatibility issues for tech industry transactions?

The EOTB is an important preparation process that prepares the Target for an intending sale. While the cost of hiring external advisers to assist with the EOTB and plugging identified holes may be off-putting, the enhanced value of Target following the EOTB is well worth that investment.

At what point should you retain transaction Advisers?

A common misconception among sellers is that they do not need legal, financial or other advisory services until a buyer has been identified and negotiation is well underway. As a result, some value diminishing factors are not identified and addressed until buyers approach the seller and price negotiations commence. Hence, the seller may not obtain the best value for the sale because advisers have not been appointed early on in the process.

The best time to appoint legal and financial advisors is immediately a sale is anticipated. A deal savvy legal advisor will lead the seller through the EOTB analysis as soon as possible, and ensure that identified loopholes are quickly plugged.

Lessons and Conclusion

The role of strategic thought and planning in the sale process cannot be overstated. Adequate strategy and planning could be the difference between a value creating sale and a sale which merely meets or does not even meet the asking price. Achieving good value from a sale requires a mental shift on the part of sellers, from reactionary/receptive partners in the M&A dance, to proactive partners who contribute just as much as the buyers in unlocking the value of M&A deals. It is when this value is unlocked that a seller can command premium purchase price and sale value. Transaction advisers are as important to sellers as they are to buyers.

Engaging them early on in the process is value enhancing.

About Niccom LLP

At Niccom LLP, we advise on Mergers and Acquisitions, and we understand the intricacies of deal making and structuring. We are happy to advise you on structuring and negotiating that deal irrespective of the side of the deal you are negotiating from, be it the buy-side or sell-side or even a merger properly so-called.

We are a full-service law firm comprising of experienced and innovative minds. We provide legal and compliance services to clients cutting across different sectors and backgrounds. We operate out of Lagos, Nigeria, but represent clients across sub-Saharan Africa, Europe and the Middle East.

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