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Investment Bankers Don't Have Magic Words

Takeaway: Investment bankers do not have magic words that they whisper in the ears of buyers to get them to pay more for a company. Sellers should be wary of any advisor who says (or implies) they have that ability. Valuation is the intersection of competition, the strength (or weakness) of the underlying business, honesty, the want/need of the buyer, the motivation of the seller, the tenor of the times, and the skill of the investment banker.

A pleasant surprise for many business owners is the discovery that finding buyers for their businesses is not difficult. In good economic times and bad, companies want to make acquisitions. Perhaps buyers are willing to pay more in good times, perhaps companies with some "hair" more readily will find buyers in a frothy market, but the bottom line doesn't change: Finding buyers is not difficult. Frankly, finding a buyer is the easy part. Closing a deal that makes sense for the seller is the tricky part.

I suspect the reason for the surprise is due to the bias of our own experience. As anyone who has tried to sell a product or service knows, making a sale can be a very difficult proposition. What salesperson hasn't daydreamed about sitting on the other side of the table and making the buy decision?

Therefore, when a business owner finds he is actively negotiating with a buyer (often in response to an unsolicited offer from a single buyer), the business owner believes the difficult part of the process is over. In reality, the most difficult parts of the M&A process are starting: due diligence and purchase agreement writing. These final steps are where an inexperienced and unprepared seller can see the value of the deal whittled away as a savvy buyer might attempt a renegotiation of the deal at a lower valuation. Defusing problems and fending off attempts to renegotiate deals are where investment bankers earn their fees.

And if you hire a good one, they will be worth every penny you spend.

Value is an Intersection of Many Variables (not Magic Words)

A mistake some business owners make is to expect an investment banker to work some sort of M&A voodoo and get a buyer to magically increase an offer. Since most buyers are sophisticated they will reject an overture to negotiate against themselves. Investment bankers do not have magic words that they whisper in the ears of buyers to get them to increase their bids.

Instead, valuation is the intersection of of many variable. Here is a summary of these variables:

Competition from an Orderly Process

Running an orderly process means the investment banker will create competition. Competition breeds options and, in the hands of a capable advisor, can be a boon to valuation. Only after a suitable amount of competition has been created can an investment banker's negotiating skills be fully leveraged to maintain and maximize valuation. Absent options born from competition, the ability to negotiate will be severely limited.

A seller who negotiates with only one buyer (or a very limited number of buyers) runs the risk of leaving money on the table. Would other buyers be willing to offer more? A seller will never know unless multiple offers are received. In an M&A process, all suitable buyers will be contacted, appropriate information will be provided at the right time, and interested parties will submit offers. This "clearing of the market" provides the seller with a full range of options.

Strength of the Underlying Business

Simply put, a company with growing revenues, a strong bottom line, no customer concentration, and a strong management team will be more desirable than a money losing company. If the fundamentals are sound, the seller can expect a good valuation. But just because the original offer is strong does not mean the seller will get to the finish line with that original valuation intact. Having multiple options means a seller has a far better chance of maintaining the valuation in the offer.

Honesty

One sure way to scuttle a chance to put together a deal is to mislead and misrepresent. Lack of honesty will very quickly ruin a seller's credibility, thus tarnishing valuation and perhaps making a deal virtually impossible to close.

The Need/Want of the Buyer

A buyer who wants a particular company more than all others will be more likely to pay a higher price. The best way to find that buyer is by an investment banker's ability to run an orderly process that "clears the market" by generating multiple offers as discussed above.

Seller Motivation

The inverse of buyer need/want is the seller's motivation to pursue a transaction. If a seller has few options and is desperate to do a deal - any deal! - that desperation will drive down valuation. A seller at the helm of a financial sound company with multiple offers in hand will be in a much stronger negotiating position.

Tenor of the Times

We are currently experiencing a rather frothy M&A market. Demand from buyers far exceeds the supply of companies coming to market and that is driving up valuations. I recently had lunch with a private equity professional who quipped, "6X is the new 5X."

The reasons for the current situation are manifold, ranging from a surfeit of liquidity created by the central bank's loose money policy to excess capital on the balance sheets of corporations and private equity firms to a low interest rate environment. Today's low interest rates mean a business owner has a difficult time replacing income from his company with income from fixed investments. This reduces sellers and puts further upward pressure on valuations.

Skill of the Investment Banker

When I think about the deals I've executed, the real value that we have provided a client comes in the final throes of due diligence and purchase agreement writing. Yes, the preparation of materials and a buyers list are very important. Yes, the dissemination of those materials to the buyers is very important. But the biggest value, by far, comes during the final few days before closing.

No Magical Slight of Hand

What might seem like magic words is really the confluence of a multitude of occurrences, all orchestrated by the hands of knowledgeable and experienced advisors. Magical valuations can be had, but they are not the result of magic, they are the result of skill, foresight, planning, experience, and execution.

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