Private Company Services
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Finding the right buyer

Exit Focus Series
Part Two of Five

The second part of the series looks at the business through the eyes of the potential buyer, takes the owner through various deal options, and highlights some of the key value drivers that gain the most attention from prospective buyers.

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Introduction

Following our first Exit Focus report about positioning your business, this second part looks at your business through the eyes of a potential buyer and takes you through various deal options. We examine the pros and cons of each, and why you – or a buyer – may have a preference. It also highlights some of the key value drivers that get the most attention from different types of buyers.

Armed with a better understanding of these issues, you can start preparing for the ultimate transfer of your business.

Many owners start out with the intention of transferring their business to their immediate family, but ultimately that may not be a viable, realistic or optimal solution. Many factors come into play. You need to think about the age of your family, their wishes and skill sets, management experience, potential sibling rivalries, and reactions of key non-family employees. To increase the odds of a successful transition, you need the input and buy-in of everyone who will be directly affected by your decision.

The vast majority of family businesses not seeking or able to pass the business on to the next generation find that their only viable exit is to sell the business to a third party. Management-led buyouts can face financial and practical hurdles. And while people may talk about an IPO as an exit from the business, it's really better characterized as a capital-raising event, as opposed to an optimal liquidity event. Going public can help you free up a portion of the personal wealth that is tied up in your company, but a full exit may take years.

The best choice depends on many factors including your personal goals and financial needs, the stage in lifecycle of your business, and the state of the industry or the economy to name just a few.

Need to talk?

Whatever stage of transition your company is at, we can help you make the complex decisions that need to be made, understand the process and choose the right option to help you realize the value of your business and achieve your long-term vision.

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Executive summary

Seeing your business through the eyes of a potential buyer
Each potential buyer will weigh the value of the various components of your business differently.

Sale or transfer to family members
Transferring your business to the next generation is often an issue of estate and tax planning rather than structuring a deal. There's still plenty to think about, however.

The strategic buyer
Strategic buyers see your business as a way to acquire elements that fit with or enhance its existing business and may be willing to pay a premium. But you need to weigh the price against the likelihood that the strategic buyer may eliminate parts of your business to achieve synergies.

The financial buyer
Financial buyers hunt for opportunities to invest in companies, work to accelerate their growth, and exit for a profit in the short to medium term. To be attractive to a financial buyer, you ideally need solid cash flows, a defendable market position, products and services in markets that are growing, and a management team capable of driving the business forward. Increasingly these days, however, distressed funds also constitute a segment of the market. Operationally minded financial buyers may be interested in turnaround situations or deals with more complications.

Corporate partnerships or joint ventures
Entering into a partnership or joint venture may be a strategy to consider if you and another business identify mutual benefits. However, these types of arrangements may also delay exit by years.

IPOs
You may start thinking about going public when the funding required to meet your business growth objectives has exceeded your debt capacity. But beware, the costs of an IPO are high, and sellers rarely have as much control after the transaction as you might expect.

International buyers and private investors
Finding the right overseas buyer can unlock significant value but the process is more complex. You may want to use advisors with international networks who may have more direct and timely access to a larger pool of potential buyers, and who have experience managing the process through to completion across borders. High net worth individuals are also looking for innovative ways to spread their portfolios, so your network must extend far and wide to get the best deal for you.

Keeping your eye on the goal
The right buyer may at first seem like the one who attaches the most money to your business. But choosing the deal that's right for you may not be all about money; only you can decide. What's most important is your definition of value. It's not until you know what value you're looking for that you can engineer the deal that will create it.

Seeing your business through the eyes of a potential buyer

Potential buyers look for indicators of a strong, successful business. These include competitive advantage in the marketplace, a diverse customer base, and a solid business strategy. Even when an investor plans to bring in a senior management team, the strength and depth of the overall management group will be a key area of focus. A talented team has become increasingly important in a competitive, globalized marketplace.

But each potential buyer will weigh the value of each of these components differently. By understanding what a potential buyer values, you can understand how they will view your business as a potential acquisition.

There are three different broad categories of buyer:

1. **Logical, strategic or pure-plays.** These include your competitors, or companies looking to get a foothold in your industry or geography.
2. **Vertical integrators.** These can be found by looking up and down your supply chains.
3. **Financial buyers.** These more opportunistic buyers may or may not have expertise in your industry and are interested in investing capital and leveraging operations with debt. Financial buyers look for short- to medium-term appreciation in the value of your business or a broader consolidation play.

You need to understand the goals of each of these potential buyers and how they develop and execute an acquisition strategy.

What's your exit strategy?

You need to finalize an exit strategy that meets your goals and creates the most value for you. Deciding your objectives is the best way to start identifying the right buyer for your business.

Five of the most common strategies are:

- Selling or transferring ownership to family members
- Full or partial sale to a third party
- Corporate partnerships or joint ventures
- Selling the company to employees – management buy-out (MBOs)
- An initial public offering (IPO)

Selling or transferring to family

Apart from the financial considerations, one of the first things you need to decide is whether to keep the business in the family. Frequently, the emotional and personal issues around family business succession are more difficult to resolve than business or financial concerns. You need to address these sensitive issues before you look at the business challenges.

Transferring your business to the next generation is often an issue of estate and tax planning rather than structuring a deal. How and when you relinquish management control is also a primary concern.

Some of the advantages and disadvantages of selling or transferring your business to family are listed below.

To increase the odds of a successful transition, you need the input and buy-in of everyone who will be directly affected by your decision.

Advantages	Disadvantages
Allows family members to enjoy fruits of owner's labour	Estate transfer may require significant funding for capital gains tax if assets do not qualify for business property and entrepreneurs relief
May allow for involvement of other key managers	May need to prove the price paid is reasonable
Owner's legacy lives on	Salary continuation agreements need to be established in light of value paid for the seller's shares
Minimal cultural disruption	Family members might not have the right skills or desire to manage the business to best effect
Tax efficient transfer can be accomplished with proper planning	

Strategic buyers

Strategic buyers seek synergies with your business.

A strategic buyer seeks a good fit with some aspect of your business. The strategic buyer is often in the same business and trying to access new markets, brands, market share, or expertise. Strategic buyers see your business as a way to acquire elements that fit with or enhance their existing business. Often this stems from their analysis showing that it is cheaper and faster to buy an existing company than it is to build or develop their own from scratch.

Our experience shows that the top elements strategic buyers typically look for are: access to new markets, products, technologies brands, management or technical talent.

Strategic buyers in a similar business probably have a sense of your financial performance in certain areas, even where this information is not publicly available. They will be looking for synergies that enhance their business.

When the synergies are significant, strategic buyers are often willing to pay more, especially when those anticipated benefits are specific to the buyer and are achievable with relatively little investment or integration planning. When considering a strategic buyer, you need to anticipate these possible synergies in order to capture the potential value associated with them. These can be additive, such as combining technology and expertise, complementary geographies and product lines, or reductive, where there is an opportunity to take out costs, people, or duplicated functions.

Owners should consider the ramifications on employees and stakeholders, if these are important factors. You will need to weigh the advantage of a possibly higher sale price against the likelihood that the strategic buyer, as part of achieving its synergies, may eliminate a portion of your existing management team post transaction.

Financial buyers include private equity, venture capital and investment funds. Unlike strategic buyers, they may not be focused on synergies from the immediate

Advantages	Disadvantages
May provide highest valuation	Management may lose autonomy, lose their job in the near term or have their roles diminished
Usually offer the owner the option to completely walk away	Possible negative impact on culture and morale
Potential operating synergies can improve the business	May affect customer loyalty
Typically, strategic buyers are very knowledgeable from an operational and business perspective, facilitating due diligence and closing	Upside value potential may be sacrificed (unless there is significant shares or earnout consideration)
May be able to close more quickly than financial buyers	A secondary concern is related to access to competitive information, should the deal fall through
Qualified buyers may not be constrained by financing contingencies or be at the mercy of the credit markets	

Financial buyers

Financial buyers are more likely to be focused on short-term investment goals.

transaction. Financial buyers hunt for opportunities to invest in companies, work to accelerate their growth, and exit for a profit in the short to medium-term. While some financial buyers may focus on particular industries, they are often more generalized in their targeting. They may also consider the attractiveness of your business alongside your industry sector prospects.

To be attractive to a financial buyer, you ideally need solid cash flows, a defendable market position, products and services in markets that are growing and a management team capable of driving the business forward. Their ability to leverage the business is a key factor in driving the price, and the health of the credit markets also plays a part.

Distressed funds constitute a less well known segment of the market. Depending on the reasons for a company's troubles, operationally minded financial buyers may be interested in pursuing turnaround situations or deals with more complications.

Typically, financial buyers are extremely sophisticated in terms of deal structure and diligence. In order to achieve their targeted investment returns, they will generally finance the acquisition with significant leverage (i.e. additional debt). As a result, they are more sensitive to issues, such as management quality and depth, sustainable EBITDA (earnings before interest, taxes, depreciation, and amortization), and free cash flow.

Advantages	Disadvantages
Provides access to "deep pockets" for acquisitions	Upside potential is dependent upon strong management direction and growth
Current management/shareholders will likely maintain significant involvement in direction available for growth	New owners will significantly focus on growth initiatives
Entails relatively less business disruption and effect on customer loyalty and employee morale	Heavy debt load limits margin for error
Current management/shareholders may retain upside potential	May require ongoing involvement of owner in business in short term
May provide owner with ability to realize additional returns	Financial reporting requirements likely to increase
Can offer transaction structure flexibility	Requires extended due diligence period because of reliance on lender participation

Corporate partnerships and joint ventures

Entering into a partnership or joint venture may be a strategy to consider if you and another business identify mutual benefits. It also can provide an alternative if you don't want to sell your company right now or if one party wishes to explore a relationship before an acquisition. Perhaps an otherwise potential buyer is not interested in buying because your business is not in a high-growth phase but is in a market that is attractive.

Advantages	Disadvantages
May provide access to new markets	Complicated to set up with appropriate detail
May expand product offerings	Can be difficult to sustain long-term
May deepen relationships with customers	Partners may not be contributing equally or may have disparity in economic leverage and strength
May provide access to technology, people, material supply, and capacity	The needs and interests of the parties change
May provide opportunity to acquire partner or to be acquired in a two-step process	May delay the exit process by years

Initial Public Offerings (IPOs)

You may start thinking about going public (offering securities of the company for sale to the general public) when the funding required to meet your business growth objectives has exceeded its debt capacity. While under the right circumstances "going public" may be attractive, the costs of an IPO are high, and sellers rarely have as much control after the transaction as they expect. Given the complexities of today's financial markets and heavy costs of exchange listed status, you should consider very carefully whether the public market option is the most logical in light of other alternatives.

International buyers and private investors

In addition to all the various types of buyers and their motivations, you also need to consider whether your business is of interest to international buyers. Finding the right overseas buyer can unlock significant value but the process is more complex. You may need to use advisors who have international networks and knowing how to manage the process from identification to completion across borders is key.

Increasingly, with low returns from more traditional investments, many high net worth individuals are also looking for innovative ways to spread their portfolios, so use an advisor who can access this network.

Advantages	Disadvantages
• Provides access to long-term capital	• Pressure for short-term performance
• Improves financial position	• Lack of operating confidentiality
• Provides liquidity for shareholders	• Reduced business flexibility
• Prestige and public awareness	• Initial and ongoing cost, reporting and governance requirements
• Increases ability to attract and retain key personnel via stock options	• Executive compensation scrutiny
• Additional finance for future acquisitions	• Potential accountability to public shareholders

Keeping your eye on the goal

Identifying the right buyer is dependent upon, first, identifying your goals. Do you want to retain a financial stake after the sale in order to participate in some upside potential? Or are you ready to completely cash out? Do you want to retire or do you want to remain involved in the business? If you want to remain engaged, what amount of control would you like to keep and for how long?

Secondly, finding the right buyer for your business is possible only when you have thoroughly considered your priorities. These include both business and personal and both financial (liquidity, sale price, taxation/estate planning) and non-financial (succession, legacy and reputation, employee and stakeholder concerns, family dynamics, etc).

The right buyer often looks like the one who attaches the highest price to your business. But choosing the deal that's right for you may not be all about money; only you can decide. For example, you might look for a buyer who will keep your name on the door, or who won't fire key employees for three years, or who agrees not to close your plant and take all of the production to another country.

What's most important is your definition of value. While this decision may not be simple or straightforward, gathering information on the pros and cons of each option, as well as the likely process that will follow, is a good way of helping you creating the best value for you and your family.

To maximize your value, you need to be in control of the process from start to finish, which requires detailed thought and planning.

About PwC's Private Company Services

More than 65% of PwC Canada's clients are private companies, ranging from high net worth individuals to owner-managed family businesses and large, professionally-managed businesses. PwC's Private Company Services (PCS) group is a dedicated team of business advisors who help private company owners resolve day-to-day business issues and achieve long-term success. PCS offers the perspective of a third party with professional industry knowledge, business consulting, tax and accounting expertise.

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