AXIAL FOR ADVISORS

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12 LESSONS TO BUILD A

# SUCCESSFUL BUYER LIST

FORUM
THE SELLER SERIES

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# The strength of your buyer list can make or break your chances of success.

Finding the right acquirer for a business can be the most challenging task in M&A.

Prices can always be negotiated if people don't agree. Alternative targets can be found if you lose a deal. But you can't sell a business without an acquirer.

For sellside advisors, the one thing with the highest impact on whether or not you complete a sale is the strength of your buyer list.

Building a top-notch buyer list can single-handedly help one investment bank win a deal over another. This guide will show you how to construct a buyer list that will ensure a successful close.

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# 12 Lessons to Build a Successful Buyer List

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**LESSON 1**

## Structure Your List in Tiers

Set your list up in tiers arranged by descending buyer likelihood. This will not only help guide later stages of the deal, but will also help you come up with a robust list of buyers. “We’ll start looking at the potential buyers in terms of concentric circles,” says Joe May, Axial member and managing principal at Graham Partners.

> **Tier 1 buyers** are businesses with a high likelihood of interest in the target. These are often the business’s direct competitors.
>
> **Tier 2 buyers** are slightly less likely to make the investment. They probably have some presence in the sector or may have indicated that they are looking to grow their capabilities.
>
> **Tier 3 buyers** are more unlikely prospects. They may have operations in an adjacency and be somewhat interested in establishing a presence.

“The inner circle are the ones that we’re definitely going to call,” says Eliot Peters, managing director at RA Capital Advisors. While the outer circle may not be called at all, “[they] still make sense” as potential investors.

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**LESSON 2**

## Enhance Deal Discipline With Financial Buyers

Should bankers limit the buyer list to strategic acquirers, or include financial acquirers as well?

**Financial buyers** include any company that invests as a business: private equity funds, mezzanine funds, family offices, independent investors, commercial lenders, and other capital providers. These firms and executives are in the business of making investments in companies and realizing a return on their investments. Their goal is to identify private companies with attractive future growth opportunities and durable competitive advantages, invest capital, and realize a return on their investment with a sale or an IPO.

**Strategic buyers** are operating companies that provide products or services; these are often competitors, suppliers, or customers of the firm for sale. An example might include an industrials company buying an original equipment manufacturer or a social media giant buying a smartphone app. They can also be unrelated to the company but looking to grow in its market to diversify their revenue sources. Their goal is to identify companies whose products or services can synergistically integrate with their existing P/L to create incremental long-term shareholder value.

**Financial buyers tend to pay less than strategic buyers. This is a consequence of two things:**

- Their mandate to hit percent return targets, which will restrict their entry price into an investment, and
- Their lack of synergies, which will depress their upfront offer.

Still, it is almost always a good idea to include financial sponsors in your buyer list.

Why?

1. **Financial sponsors help with deal discipline and pacing.**
   Anyone who has ever tried to sell a business will tell you that there are many things you'll have to overcome to make it to closing. Buyers need more information. Sellers need more time. No one is ready to make decisions. Inevitably, unexpected hiccups mean even the most veteran M&A bankers have an exceptionally tough time running a smooth and expedient process.

*Financial buyers tend to pay less than strategic buyers — but you should still include them on your list.*

But financial sponsors are pros when it comes to sellside processes. They'll typically go through dozens of processes a year. As a result, they tend to have an excellent grasp of structure and pacing. They know what the standard process looks like, exactly what the next step is, and when you should be there. They know how a normal NDA looks, when to submit it, what needs to be in the data room, and how to structure a LOI.

Plus, they're busy. With multiple parallel processes running, investments that they have to exit in the next few months, funds that need to be deployed within a certain time frame, and their own timing checks, they'll help keep the process on track and moving forward.

2. **Financial Buyers Boost Deal Certainty**

Sponsors — whether PE, mezz, or otherwise — are driven by an internal rate of return (IRR) target. The amount that they're willing to pay will be predominantly based on the exit price, forecasted performance, and the IRR that they need to hit. They will then solve for the entry price.
While they generally pay less than strategics, sponsors are more likely to come to the table.

RA Capital Advisors managing director Peters explains that he will include PE buyers on the list "no matter what.""It gives you deal certainty, because they're always there at a price."

*Financial sponsors are in the business of sponsoring growth.*

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## LESSON 3
# Go Broad

Bankers are balancing two competing interests when compiling buyer lists. They want to avoid sharing proprietary company information with more people than necessary, but also make sure there are enough high quality buyers in the pool. As a result, they'll often brainstorm a long buyer list, then trim down the pool to only a few likely parties.

**This is a mistake. Bankers should go as broad as possible. Here's why.**

1. **As a sellside investment banker, your job is to maximize value for your client.** The higher your sale price, the better your return. The stronger your buyer list, the higher your sale price. At the end of the day, it's truly a numbers game.

2. **The best buyer isn't always obvious.** Graham Peters managing principal May noted that, "bankers will sell an asset to someone in their top tier buyer list 55% to 60% of the time. That means that 40% to 45% of the time, the buyer is going to come from outside the top tier."

Adds Adam Abramowitz, Axial member and senior vice president at Intrepid Investment Bankers, "As much as you might think you know who the likely buyers are, until you pick up the phone and talk to a decision maker, you never know for sure."

*Your job is to maximize value for your client.*

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LESSON 4

## Start with Direct Competitors

The first names you should have on the page are the company's core competitors. Whenever there are two businesses competing for the same market, there will be strategic incentives for an acquisition and overlapping operations. And whenever there exists an incentive or overlapping supply chain, you will find motives and synergies.

Deal motives and synergies are arguably the two most important things to look for when building a buyer list. The greater the need for an asset, the more a buyer will be willing to pay. The greater the synergies involved in a consolidation, the more they'll be able to pay.

Competitors have a high likelihood of ranking near the top of the list on both the motives scale and the synergies scale.

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## LESSON 5
## Include Quasi-Strategic Sponsors

A quasi-strategic sponsor, also known as a "hybrid strategic," is effectively a financial buyer that already owns a related business. This is the most valuable financial buyer to have on your list.

These types of buyers behave more like strategics in the acquisition process. They will almost always have a high degree and of interest and be able to pay more.

Let's say you're contemplating inviting two PE funds to an auction for a data processing business: one that owns a business services company and one that does not. The former will instantly have strategic incentives to add that asset to their existing portfolio company. It will also be likely to realize synergies upon a consolidation of the existing businesses. These factors escalate the former fund's motivation to win the auction, and its capacity to pay.

Quasi-strategic sponsors are likely to have incentives to get a deal done sooner rather than later. If they see your company as an add-on, it may also unlock other milestones in a core investment that would otherwise be impossible.

As Peters explains, "the best financial buyers are those that already own a platform business. They don't need to be convinced of the value proposition, because they're already aware of it... they add value to the process because you have a financial buyer that basically has strategic motivations. And in fact, they'll often be a lot more creative in putting two things together than a standard strategic, which may or may not be highly focused on their own internal roadmap."

Quasi-strategic buyers will often rival the best of your strategic buyers. While they may pay more or less than a strategic, they'll almost always be able to pay more than a standard sponsor.

Moreover, they come with all the fringe benefits of a financial buyer: They're used to being on a schedule, they'll execute at a deliberate speed, and they'll often act opportunistically and be open to something less on-target if they see the financial value and are bound by an investment horizon.

*Quasi-strategics will almost always pay more than a standard sponsor.*

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LESSON 6

## Prescreen

Validating buyers in advance will help keep the deal process tight and make sure you have a buyer in the room. When you're done building your list of Tier 1, Tier 2, and Tier 3 buyers and have diligently combed through direct competitors, indirect competitors, and financial buyers, you should not include all of them in the sellside process.

Here, you need to sit down and identify the capacity of each buyer to do a deal. Here are a few questions to ask.

→ **Have they historically been acquisitive or have they prioritized organic growth?** You might think you have a great large cap pharmaceutical buyer for your biotech company, but if they always develop new drugs in-house and are heavily funding internal research and development, they're unlikely to spend $400mm on a biotechnology company.

→ **Do they have enough cash?** Did a strategic just raise a round of debt? Did a sponsor just raise a new fund? How big is the fund? If not, figure out if they're even financially capable of doing the deal. Conversely, is the sponsor closing out on its first fund with just 6 months left to invest $120mm? If your asset is a good fit and size for available capital, perhaps you have a perfect buyer on your hands.

→ **Have they done any recent transactions?** The management attention and time involved with even a small acquisition can render an otherwise suitable buyer unable to do a deal for upwards of a six months. With the entire corporate development team at a large strategic tied up in post-transaction duties, even if they pay feign enough attention to sign an NDA and get into the data room, your time is much better spent with buyers that have the capacity to close. Keep this in mind as you pitch your opportunity.

→ **Did they recently change strategic direction or leadership?** It's extremely important to be aware of any modifications to the internal gameplan. Particularly after large changes in direction, companies can be highly receptive, or adverse, to a transaction opportunity. Similarly, new leaders are sometimes brought in to grow the business aggressively and will be especially focused on strategic acquisitions, but you'll want to sit back if they're extremely tied up with executing the leadership change.

→ **What is their leverage capacity?** How does cash stock / equity debt mix look? This is a very important point. While you'll identify certain businesses that are ideal buyers in theory — a direct competitor for example — chances are that one or more will be unable to even execute the transaction. Examine each player's tactical ability to make the purchase and not just its strategic need. A buyer without the ability to close the deal should not be at the top of your list.

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**LESSON 7**

## Include Specialist Sponsors

Specialist firms allocate all their attention, time, and resources to one or a few sectors. This niche aptitude is almost always your friend in a sellside process. May explains that "many financial buyers will have an investment professional that's focused on an industry — the partner that's been deemed to be the building products guy, the chemicals guy, or the foods guy." They've spent time "learning the space, getting to know sector bankers, and building industry relationships," and may have a record of investments in the sector.

Specialist funds may focus on 2-4 industries, but will often choose markets that are linked, e.g., renewable energy and infrastructure (for which there is a strong project finance and real estate focus) or healthcare and technology (for which there is a strong need for pre-revenue operating expertise).

Specialist players will not only prioritize certain industries or sub-sectors, but will frequently hire operating partners and advisors with strong experience in the space. As a result, they tend to have a deeper view on the market, better insight into the players, a stronger angle in investments, and advanced proficiencies in improving troubled businesses. These factors will frequently increase both the price that they're willing to offer and the likelihood that they'll close.

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## LESSON 8

# Include Buyers with Unused Capabilities in the Sector

There's a lag between when a sponsor raises a fund and when it finds an appropriate investment opportunity in a certain industry. As a result, there are periods during which funds will have experts in a specific industry who aren't using their expertise in the field. Months or even years might pass during which funds don't find an appropriate investment in a given sector.

1. **The specialist fund will have sharper insight, a nuanced angle, and a higher degree of focus than a generalist firm.**
2. **The specialist resource can serve as an in-house advocate of the deal.** Most investment decisions come down to consensus among partners and capacity to manage the asset. This investor will understand the nuances of the deal and the industry, and can help push things forward with the partners. As you're trying to move a deal past the finish line, this is one of the most critical advantages you can have.
3. **Unused capacity always wants to be filled.** Funds want to allocate their human capital as efficiently as possible. A building products expert can't bring the advantages to bear on an apparel deal as he would on a building products deal.

Bring investors with underutilized capacity into the process, and you may have a buyer that's happy to put more money on the table in exchange for your asset.



*Unused capacity always wants to be filled.*

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**LESSON 9**

## Include Buyers with Visible Advantages from Vertical Integration

Maintain an eye for buyers that have either expressed an interest or can benefit significantly from vertical integration.

The best buyers are often industry participants with a strategic interest in integrating backwards into the supply chain. If your asset represents an opportunity for either efficiency or financial benefit, an acquisition will be both more enticing and more justifiable for that buyer.

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**LESSON 10**

## Include Buyers with Visible Advantages from Horizontal Integration

Buyers that have an interest in horizontal integration can also add significant value to the process. An acquisition that allows a buyer to integrate horizontally will usually reduce costs, increase economies of scale, and/or improve market share.

The buyer may be interested in providing a slightly broader product mix, gaining access to certain customers, or diversifying their footprint. One example might be a buyer that has the same product portfolio as the sellside target, but has a presence on the East Coast and no brand equity on the West Coast. Alternatively, perhaps a company has a strong distribution network in Canada, but needs a strategic channel into the U.S.

Buyers that already have significant horizontal overlap with the target can also be interesting. Where there's overlap, there's two businesses running parallel operations. And where there are parallels, there are synergies. For example, two companies selling washing machines across the east coast will likely be able to cut transportation, warehousing, and distribution costs when they consolidate to one set of facilities. As a result, they'll be able to pay more.

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**LESSON 11**

## Leverage International Resources

The most agile funds and intermediaries seek out ways to form partnerships with professionals abroad. Make an effort to form relationships with international deal professionals — and don't leave them off your buyer list.

Peters explains that his practice makes an active effort to form relationships with boutique banks in other key markets, particularly Europe and Asia. "Then, when we're engaged on a sellside mandate, we can reach out and discuss the target and our proposed buyer list with them... We'll show them the list and ask for their thoughts. What are they seeing? What do they think?"

These transatlantic partners may already know the international buyers on the list, and be able to make an introduction so that you're not just another inbound email. Peters recalls a situation where he was working on a sellside process in which the company was headquartered in the United States but the best buyer was in Germany. One of the regional banks with which he had a relationship knew board members at that buyer.

An international partner will also have insight into critical areas that you may have missed. "What they bring to the table is local market feedback," explains Peter. "They'll know if a certain buyer is not ready for an acquisition or how another buyer might be thinking about the asset. They'll also say 'Hey, this company may be off the radar but you should consider adding it to your list because your asset might be a perfect fit.' Our research would never uncover that."

"If you're selling any company," says Peters, "but particularly a company that makes something, chances are there is someone else making the same thing somewhere in the world." As a result, "anyone that isn't thinking internationally about their buyer list does not have a complete buyer list."

*Don't leave international buyers off your list.*

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## LESSON 12

# Figure Out Why People Aren't Interested

Between the unrelenting internal legwork and nonstop outward-facing meetings, a buyer declining an opportunity to bid is typically met with a quick "Why?" or "Are you sure?" from the seller. Then the communication lines are severed.

Instead, when you pick up that decline call, ask the buyer for information. The buyer's feedback may uncover a flaw in your messaging, and possibly change the outcome of your process. You should walk out of the conversation smarter than when you came in. Remember:

- No matter how perceptive you may be, there will always be things you don't know and can't intuit.
- If one buyer is thinking it, chances are he's not the only one.
- You have nothing to lose from asking.
- The earlier in the process you ask, the quicker you can react.

Says John Schlesinger, Axial member and managing director at Instream Partners, "The fact is that certain people won't be interested." The key is "to find out why they aren't interested and what it is about the company that makes it unattractive."