The Deal Room Podcast

Episode 222 – The importance of understanding your most likely buyer – corporate vs individual

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Transcript

Joanna:
Hi, it's Joanna Oakey here and welcome back to The Deal Room podcast, a podcast proudly brought to you by our commercial legal practice aspect legal. Now today we talk about the importance of understanding your most likely buyer, whether that is corporate or an individual with a return guest Roy levy from Core Business Brokers. Roy is a corporate advisor specializing in business divestments, mergers and acquisitions in the mid tier market, and the SME market across Australia and New Zealand. And in this episode, Roy and I talk about the elements you need to consider when identifying where you think your buyer might be coming from, we drill into the difference between corporate buyers and individual buyers, we look at the most overlooked differences in selling between the two. We also explained the advantages and disadvantages of working with each type of buyer. In this episode, you will hear heaps of tips and tricks in getting to a quick deal and getting the job done efficiently. So here we go with our

discussion with Roy.

Joanna:
Roy, welcome back to The Deal Room podcast, I am so excited to have you back on the show.

Roy:
Thanks for having me. It's a pleasure to be here.

Joanna:
Great, wonderful. Now today, we're talking about what I think is a very interesting and important topic, the importance of understanding your most likely buyer, whether that's a corporate or an individual, maybe give us a bit of the background here, Roy? Why does it matter? Who cares who the buyer might be? When we thinking about heading out to market?

Roy:
Joanna it's a very important question when a seller asked you what is your opinion on the side of the business and you're trying to understand the business, we always ask for the background. And the reason we do that we need to understand the size of the business that the sales, the trends, very importantly, the number of employees where the markets are, because trying to understand the business, we are always at the back of our mind saying where is my buyer coming from who is the natural buyer for this business. So in typically, one can say that if a business has a value, a sale value, up to approximately 3 million, maybe even $4 million, typically, that would be an individual who is going to buy their business because the seller of their business would typically be the driver of that business, the decision maker, making all the appropriate decisions and keep that business going well and profitable. And therefore if it was sell to an individual, you'd expect that individual to step into the shoes of the existing seller do a handover and move on. That's not to say that a business of that size cannot be sold to a corporate, if it is a strategic, what we call bolt on acquisition and fit to that corporate player. But generally speaking, you'll find that individuals at that at that level up to three, three and a half million, it would be an individual, that is the purchase of their business when it comes to a corporate business, generally speaking, and again, this was the exception if one approached a corporate business or private equity type player, unless the business was making an EBITDA and its earnings before interest in tax and depreciation of at least $1 million. Generally, the answer is "Roy If it's not doing a million dollars, don't waste my time" because they have to apply a lot of management time to to assessing their business. And if it's not a million plus with a lot of options to to increase it. They're generally not interested in bonded business. So that's sort of your first definition of is the buyer an individual or corporate, it's really the size of the business. And that dictates when one should market a particular business. And sometimes there is there is a bit of a crossover when you're getting to the four to $5 million size business. Yeah,

Joanna:
and one of the things that I find interesting in this difference between corporate and individual buy is where the power sits between the two. So we Any selling to a corporate generally speaking, if the sale is from an individual, a bunch of individuals who've run the business, you know, almost from start-up or for a long period of time, usually, that's the only business and they know, they're not experienced in the process of selling a business, selling to a corporate, you're selling to someone who was extremely experienced in the acquisition of a business has advisors who are extremely experienced in the acquisition of a business. And that power, differential a disparity can sometimes be a huge problem, if we've got a seller who hasn't got access to the right advice, in my opinion, you know, I've seen, you know, some difficult situations caused by parties that have not had the right representation. And perhaps they've worked that out along the way, or, or whatever the case may be, maybe, can I get your opinion, Roy young, what are those what are the most overlooked differences in selling to a corporate buyer rather than an individual, and that might be within the transaction itself, or even in the lead up to the transaction in terms of how to make the business attractive to one or the other.

Roy:
The key aspect of that, first of all, is the role of the current owner and the functions he or she

plays in that business. Remembering if it was an individual who is the buyer, they would be expected to step in and into the shoes of the of the owner, learn from him or her and then run the business as the decision maker going forward. In the case of a corporate transaction, generally speaking, unless it was a really strategic bolt on and there was some individuals, a corporate player would not expect you to come in and sit in the shoes of the of the current owner, they would expect the organizational structure to be in place, that the business continues pretty seamlessly into the future, once the current owner steps out. So that's the one key difference, who's going to continue to run their business going forward, when the owner eventually leaves. And there's often a disparity or gap in that. So if you're saying to the current owner, if there's someone in there with General Manager that can step up into his position, start training that person upfront and be ready for the transition. So again, one can answer that question constructively by saying we have a competent general manager who can step up and take over my position without missing a beat. So that's one critical aspect. The next critical aspect is the the due diligence of a corporate owner, very often a corporate owner would be happy to purchase the business as a going concern, but the equity, they will purchase the shares in the equity, because it makes the transaction a lot cleaner, in that no contracts need to be changed, nothing needs to be changed, everything remains the same. However, the due diligence requirements for that from the from the buyers perspective, is quite significant. And therefore, with that expectations in mind, and of course, by the way, the seller would first have taken the advice from his accountant, what are the capital gains tax implications on the sale of the business, and should the transaction, preferably be a share sale or an asset sale, so that will that will first determine, and we always encourage ourselves to have that conversation with their accountant together with us, so we understand what it is. And if the impact as we as we just had last year, was that whatever advice was infected was that that business that I've mentioned to you, in a previous talk, the manufacturing business, the advice was, sell it, sell it with the shares. And then when we got a share, that had made it made an error, it was going to cost the seller, half a million dollars of capital gains tax. And we had to then backtrack and go back to the to the seller, and apologize about the mistake, and then say, it now has to be a che self or SSL, I can't remember which one it was. Luckily, we've got that across the line. But it's important to determine that early so that the information memorandum specifies exactly the nature of the salad, what it's going to be, but the corporate player, it's important to have all the backup in the data room ready to go for due diligence, which has an audit trail back to the IBM that whatever we saying we'll check out in due diligence, which a corporate payer will undertake. And that that could be quite time consuming as well.

Joanna:
Yeah. I just want to pick up on a couple of things that you mentioned in one of the things you mentioned about the benefit if you if you think that your buyer might be a corporate buyer or someone who wants to come in and see a management team continue, without them having to come in and run the business themselves as a buyer, you need to think about who you're going to have as say, for example, a general manager on board and you know them trained up so that they can stay on with the business, just want to point to the absolute importance in that instance of recognizing that you've now transferred a bit of that race to that to key person risk in that general manager. And so you just need to it's an excellent strategy, but also then needs to be paired with this, what are you going to do to make sure you retain this general manager that you've brought on board, and that they don't run off with what has now been created as a lot of value sitting in that person as well. So that's an you know, that's where we can think about some of these creative elements in terms of, you know, remuneration. For those key staff members, based on the price you're achieved based on staying in the business for a particular period of time, if there's an earn out, maybe even getting the buyer on board to giving them a bit of a bringing them into equity as part of the deal, those sorts of things. But super important to have your mind on that, before the GM runs, rather than after. So that's just my one point on on, you know, to back up what you're talking about there. The other thing, I just thought may and maybe we should sort of we talked about the differences mechanically, or from a technical perspective, when you're looking at a corporate buyer versus an individual buyer and from the preparation. But maybe we haven't talked about the advantages, because I think one of the big advantages out there is, as soon as you can open your business up to a sale to a corporate buyer, as well as potentially individuals, maybe you not only do increase the pool of possible buyers for a

business, but corporate buyers will most often pay more than an individual buyer as well, particularly if there's a strategic advantage for their business. So I think that's another, you know, and that's quite often why we see isn't it our, our sellers really keen to think about the sale to a corporate buyer, because they can they understand that potential uplift in value

Roy:
That is correct Joanna so typically, you're fine and depending on the size of the business being sold, if it's a larger business with a transaction value, and what we call an enterprise value, upwards of 10 million plus, they typically your corporate player comes into play. And in that corporate player is, for example, a small cap public company, which will typically be trading on a price earnings ratio of 10 times, then they could afford to pay a higher price. And it would still be earnings positive for that, quote, for their public company to pay a higher price. So there's no question that they're on that basis. If that is your targeted buyer, your price expectation would be higher. The other side of the equation, of course, is that that corporate buyer independent directors on the board, in the independent directors, of course, before they sign off on a deal of this nature, like to really what we call de risk.

Roy:
And therefore, they're one of the requirements, what is what we call an earn out. It's not there's not a definite requirement, but it's one of the preferred requirements to say, Mr. Seller, Mrs. Seller, if you're telling me you're going to make $2 million dollar profit last year, we are buying the future you've had the past. And if we're going to price the business on $2 million earn out, we need to be pretty certain that is that is what we're going to earn in the next year or two. So that is where they make one of the conditions and earn out for their business, to de risk it and make sure the profits are what has been achieved in the past. Many private sellers don't like that, in fact, the majority don't like that. Because if the new owner runs the business in a different way, then of course, the earnings may not be there. What we've done on occasions, is say to the buyer coming in, we don't know how you're going to run this business, we're not sure what expenses you're going to load or not load into the business and we cannot control that. So one way of doing an earn out is make it on a simple number such as a sales figure, because that's something that may or may well be controlled.

Roy:
So if it's going to be an owner trying to simplified with a figure that can be measured a lot easier than a profit, where you've got to have a host of expenses that you can cannot control. So that is one way of making it simpler. And the other thing is of course, if the seller does agree to some kind of burnout, then we would encourage the seller to stay on for the period of the earn out, say 12 months so that they can be there and control and assist to make sure that those that that number is achieved. And it's not left to someone who may not run the business well, to not achieve that, and that will then affect the earnings of the seller. So there's a number of considerations you know, to play with when you're considering an earn out. If it if it turns out that way. Of course, the price for an urn out can be even a little bit higher. If the seller is insistent that they will not do an earn out, then the corporate player may still go ahead, but dropped the price a little bit because of the earnings risk. And that's, that's an option. Sometimes a seller will turn around and say, well, that's fine, I'm happy with that. I'm happy with the price. And let's do it on that basis. So that's the difference between a typical corporate player versus a profit into individual one business.

Joanna:
And I just want to add into that, I would say and I alluded to this earlier, so repeating the concept a little bit, but just the absolute importance for sellers, to a corporate buyer, having someone who can be in your corner, who understands the game who understands what to look out for. Because often, you'll end up with the contract, and being driven by and drafted by the corporate buyer in that instance, they can be really long contracts, they can be very complex contracts. And it's super important that you have someone in your corner who can pick out where the issues are, and what are real issues versus what might be red herrings because you don't want to be caught in, you know, this constant forwards and backwards of endless negotiation, we're still death by email negotiation, you know, constant red lines forwards and backwards, you have

to have someone in your corner who can get in there and argue, you know, reasonable.

Joanna:
Say, for example, you've got an earn out, there's a whole heap of controls that we can put in there for earn outs, you know, if you're forced into, and a bit calculation for the earn out, so an earn out based on profit, as opposed to top line revenue, I completely agree with you about, it would be so much better if you can control it and make it simpler related to top line revenue. But we all know sometimes, quite often, corporates will come in and require the amount to be based on profit, but then you just you need the right clauses in there, you need the controls, you need to make sure the earn out accounts are prepared by stripping out any extra costs that had office may have put in there or extra expenses, they've lumbered on the business, or indeed protect them if, you know, there's no, there's no commitment to continue marketing the business or doing the sorts of things in the business that are required to enable the business to continue to grow to meet the earn out. So I guess that's, you know, just the last thing I want to put in there. It's critically important if you're looking at selling to a corporate buyer to understand that you need someone in your corner who understands the area,

Roy:
Joanna, that that is absolutely critical. When we when we sell the business, and we start the process of preparing the business for sale. One of the questions we immediately ask, Who is your accountant, and who is the solicitor that you that you use, because if it gets to the sale, you need to have the appropriate consultants and professionals on your side who are able to manage a transaction of this nature. And that is very, very critical. If for example, and it's the solicitor of the seller has really been instrumental in in doing leases, and that way they their speciality lies with respect, we will suggest that maybe we should be looking at a corporate solicitor, who has a lot of experience in this, this element of a sale via the share transaction or whatever. And our role will be once we've got a deal in place to in a term sheet negotiation of a term sheet, and then it goes to you know, due diligence with the accountants getting involved and then contracts of sale. We then become the choir master making sure that all elements of the deal or control whilst that the owner of the business continues running his business, because what we found is the transaction is one it can be a term sheet can be side, it takes time. It takes weeks and sometimes months. And right at the end before contract is exchanged. And remember there's no deal legal director that exchange the buyer then comes back and says to him, by the way, how's the sales been going for the last three months and if the owner has taken his eye off the ball during all this work that's been going on, and the sales have deteriorated a little bit that can scupper the whole deal and we back to zero. So I always say to the vendor, this now now's the time to work even harder than you have before. So that when the question comes, and it will, how's the last three months gone, you can show them that it's better than ever, the deal will move forward, because I know that they bought a good, they're buying a good business. So it's very critical to have all the elements in place trustworthy, competent people, so that he can continue to run the business and what goes on behind the scenes, he can be reliably informed as appropriate to make the decisions and his advisors are running behind the scenes and getting the job done.

Joanna:
Yeah, and getting the job done efficiently to you know, one of the things I always say, a quick deal is a good deal. A good deal is a quick deal. there and, you know, not always the case, but I do find that, you know, one of the greatest frustrations, I think, in this space can be and, you know, certainly some of the frustrations I have with counterparties in this space sometimes is just the slow approach. You know, that can happen with, you know, parts of the day deal team, the legal team, the accountants, whatever the case may be. And I hugely subscribed to the theory that you should not have millions of drafts and redrafts flowing between the parties, you get everyone together quickly, to negotiate any issues all together in an all parties meeting you get through them, you get to an answer, and you get the deal done. And I just think that is so critical as well to that component of the business. And the business owner, the business owner, being able to maintain focus on the business and not getting side-tracked by a long arduous negotiation process.

Roy:
Absolutely critical and the you know, and it's can be very taxing on me most of all, because it's often the biggest asset that the owner has. Now sitting off to this huge NBN. And when a buyer says something quite derogatory about the business as part of the negative negotiating tactics, it affects the owner and we will say to the owner, we will deal with that we are we are the the meat in the sandwich, we take the body blows on your behalf, that's our role to leave that to us. And we just it will direct you as to where you need to get involved or not. So it's very critical to do that and keep the emotional stress as low as possible. And let him just concentrate on running the business until the deal is settled and then they can relax.

Joanna:
Yeah and they can run off in the sunset with their bags of cash. That's right or stick around and work through that and now whatever. Oh Roy, I just want to say a huge thank you to coming on to the deal room podcast. How can our listeners get in contact with you if they're looking to gear up for a sale of their business orientated they're looking to buy a business?

Roy:
Easiest way to drive a jump onto our website www.corebb.com.au or send us an email at sales@corebb.com.au. Our contact number is on the website if you prefer an initial chat, and our motto is we will always respond within 24 hours to your communication via email or telephone call and we have no obligations to have a free chat to you will be our pleasure.

Joanna:
Absolutely love it Roy a huge thank you for coming on to the show today.

Roy:
Thank you for having me. It's been a pleasure once again.

Joanna:
Well that's it for this episode of the deal room podcast with Roy levy from Core Business Brokers all about the importance of understanding your most likely buyer. Now if you'd like more information about this topic, then check out our show notes where you will be shot straight across to our episode page at the website www.thedealroompodcast.com. There you'll be able to download a transcript of this podcast episode if you'd like to read it in more detail. And of course, there we will also link straight through to Roy Levy and Core Business Brokers if you would like their assistance during the sale of a business or perhaps an acquisition you'll also find details there of how to contact our Legal Eagles at aspect legal about anything related to buying or selling a business. And you can book yourself in a free 15 minute discussion with our legal team at aspectlegal.com.au, well that's it.

Joanna:
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