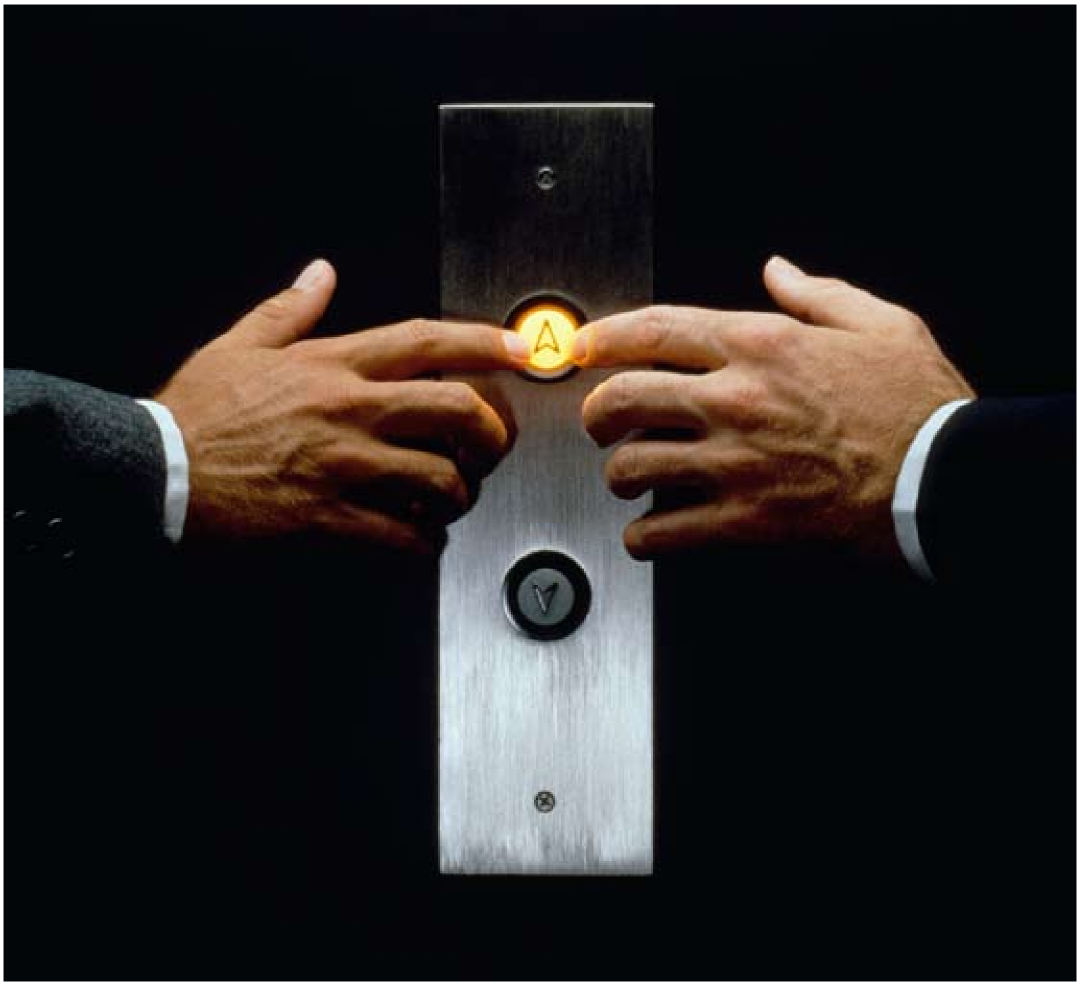
PSYCHOLOGY OF DEALS



Coming to an agreement

When buyers and sellers can't agree on price, how can advisers bridge the gap?

One of the biggest issues blocking M&A is pricing. Sellers are still keen, but clinging to pre-crunch valuations, while uncertainty makes buyers nervous. Price expectation gaps are a dealbreaker, so what are advisers doing to get deals done?

One mechanism becoming much more common is deferred consideration. The deal is priced off the most recent year's Ebitda and there is a discussion between buyer and seller, largely revolving around forecast Ebitda for the next one to three years. While this may bridge the gap, David Sonter, corporate partner at Freshfields Bruckhaus Deringer, is not a great fan: 'They inevitably lead to the seller worrying that their cash is dependent on what the purchaser does with the business going forward, so you end up in a discussion about the seller retaining some sort of control, which is a very difficult conversation.'

Any purchaser worth his salt will not want his plans hamstrung by the previous owners, while the seller won't want to be exposed to a purchaser massaging the figures to avoid payment. 'They very often end up in some sort of dispute,' adds Sonter, 'because a year or two down the track there isn't much incentive for people to be reasonable or commercially pragmatic. All parties need to properly understand that these are not perfect mechanisms, although they are one of the key tools to bridge that pricing gap.'

Known unknowns

A huge part of the pricing debate is over future performance. Are prices back on the rise or is it just a window and are they going to come down over the next 12-24 months? 'In the last three to six months the certainty about forecasts for the next 12 months has certainly improved,' says Matthew Katz, associate partner at Roffe Swayne and member of UK200Group's corporate finance panel. 'The expectation gap has changed because we all have a better idea of where we are going. Some vendors are sitting on their hands hoping for more value, but we have had a few who have decided that after two years they no longer want to run the business and therefore that gap has closed just enough for them.'

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As well as performance, supply and demand must be considered, says Alex White, partner at BDO: 'For a high-quality business whose profits are not dropping and whose turnover is growing, the price attainable now is arguably better than it would be in 12 months' time because there is a lot of demand. There is lots going on in the private equity world, but not a lot is coming to market, so those that are get special attention. Equity prices have recovered so traditional buyers without too much debt can make acquisitions. Organic growth will be tough and acquisitions may be the only way for management to show they have a plan.'

For the vendor it is imperative in this market that much effort is put into preparing the business for sale to avoid price chipping. 'Most important is the risk mitigation,' says Neil Sutton, partner and head of corporate finance at PricewaterhouseCoopers. 'Things that can drag value down, in particular the views on management, gaps in management or whether technology is undermining the business model, will be used to lower the price. Detailed preparation to deal with issues is key.'

How to get the right price

David Sonter, corporate partner with Freshfields Bruckhaus Derringer, has four tips for vendors keen to protect their sale price:

- Keep the process multilateral for as long as possible to maintain competitive tension. Going exclusive gives greater scope for value leakage.
- Keep the management team focused on the business and incentivised to maximise consideration. Nothing is more destructive to value than deteriorating financial performance of the business late in a process.
- Thorough due diligence is crucial. Sellers should do their vendor due diligence and know the key problems in the business and if possible fix them before the buyer discovers them.
- Stapled financing, where the debt is arranged in advance by the seller, lets the seller test value and can help keep the process multilateral for longer.

IMAGE: PHOTOLIBRARY