Know your Buyers: Part II

Know your Buyers is a three-part series by Valitas Capital Partners for business owners. It is designed to help owners consider the types of buyers that are in the market, how those buyers perceive value, and the advantages and disadvantages associated with each.

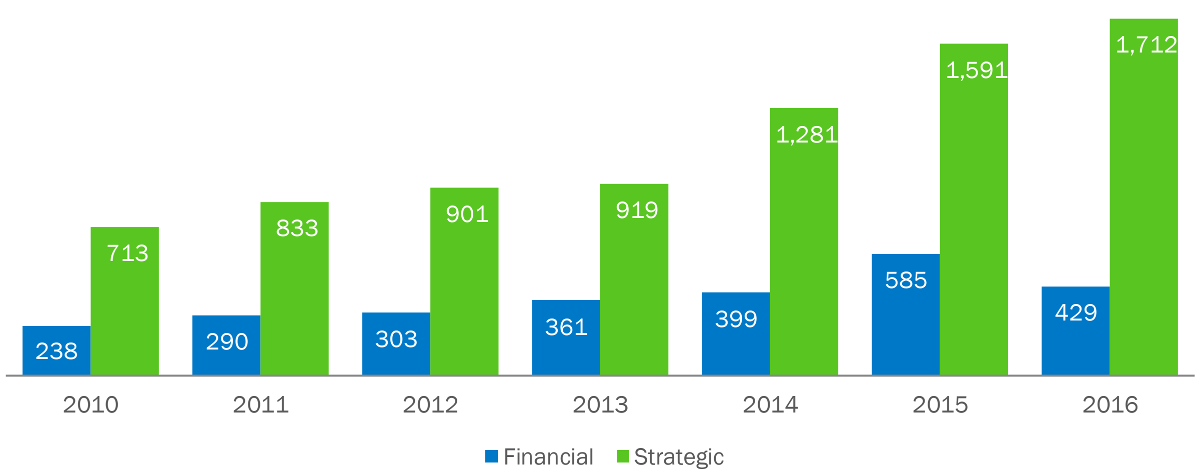
In this instalment of the series, Valitas discusses strategic buyers. Last month, we explored financial buyers and, in June, Valitas will present different business scenarios and how the type of buyer impacts sale strategy and the outcome in each case.

Strategic buyers are typically larger corporations that see a fit with some aspect of your business and perceive that synergies may be achieved by combining your business with their own. These buyers often operate in your industry and have a range of motivations for their interest including access to new markets, increasing market share, and acquiring strategic management resources, expertise, or new technologies.

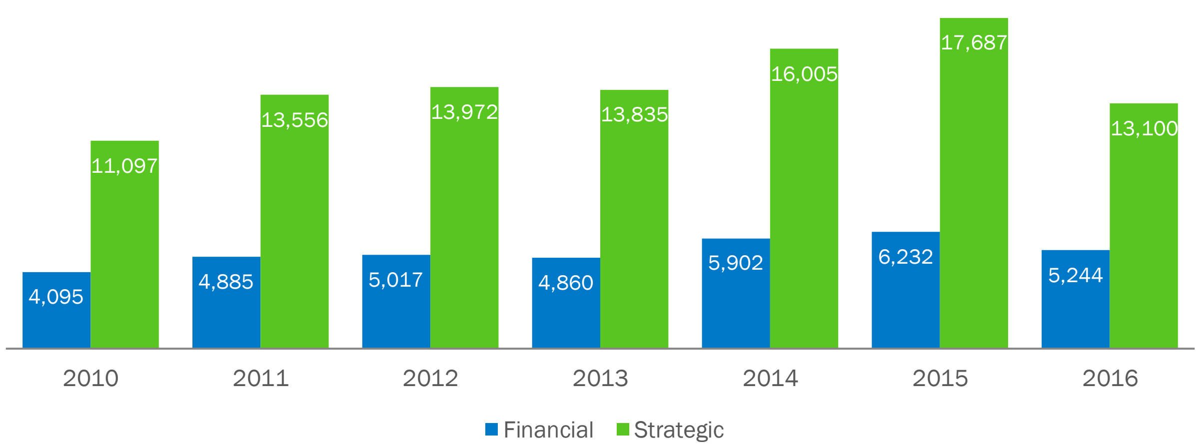
Source: PWC

Strategic buyers have become increasingly active in the M&A market, accounting for 80% of global M&A deal value in 2016. These buyers are often willing to pay higher prices because of their expectation of value creation through synergies. In addition, with corporate cash balances at ten year highs - S&P 500 and TSX 300 corporate cash and short-term investments were sitting at an estimated US$1.54 trillion in 2016 – there is no shortage of funding for their acquisition programs.

Global Value of M&A by Buyer/Investor (US$B)



Global Volume of M&A by Buyer/Investor (# of deals)



Value Creation through Synergies

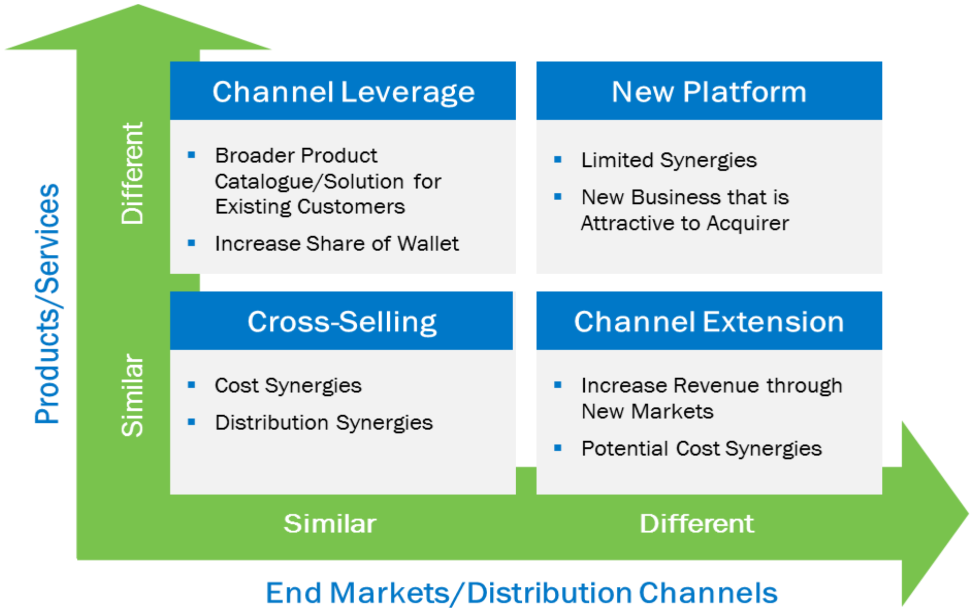
As we've noted, strategic buyers expect acquisitions to create additional value, assuming synergies are achieved. For example, if a strategic buyer offers a business owner 10x EBITDA for their business, but doubles the EBITDA through synergies, the acquirer's effective valuation would be 5x EBITDA.

Synergies are most commonly realized in the following two forms:

1. Cost Synergies: There may be the potential for dramatic margin improvement in your revenues through economies of scale and/or reducing operating expenses; and

2. Distribution Synergies: (i) selling your products or services through an acquirer's distribution channels; (ii) using your distribution channels to distribute the acquirer's offering; or (iii) a

combination of both, can have a significant impact on the EBITDA your business generates post-acquisition.



In addition, inventory and accounts receivable reductions can release cash, effectively reducing the purchase price.

Approach

While often offering the highest valuations because of potential synergies, there may be some drawbacks to dealing with strategic buyers:

- They are typically slower than financial acquirers
- Some can lack M&A sophistication, which increases execution risk
- There is a greater risk of leaks, temptation to damage a competitor in the marketplace, lack of experience with handling sensitive information
- Potential channel conflicts could undermine expected distribution synergies
- They tend to prefer a 100% purchase
- Post closing, there is a possibility of closing facilities, displacing people, disrupting business continuity, diluting your brand and legacy

Valitas has access to the strategic acquirers that are interested in Canadian businesses. We are in regular contact with dozens of the most active industry consolidators, both domestic and global. Many of these acquirers request our assistance to identify quality acquisition opportunities.

Foreign acquirers seeking opportunities in Canada often cite the lack of knowledgeable private market investment banking firms on which they can rely to identify quality mid-sized Canadian businesses. Valitas was formed to address this need. Our team leverages its previous private and capital markets experience to identify acquirers and engage with them effectively.