# Selling a business in the current high-deal volume environment

By Dustin J. Vrabel


VRABEL

Selling a business in any environment can be challenging when planning is not addressed early in the M&A process. The challenges are heightened in the current environment where buyers are looking at multiple potential deals simultaneously, expecting to close as efficiently as possible before moving on to the next opportunity. With the proper planning conducted by sellers before even identifying a buyer, however, a sale transaction can be relatively smooth and maximize value to the seller.

Buyers have limited time and resources to dedicate to potential M&A opportunities, and they need to focus on those target companies and transactions that are most likely to get to a successful closing. There are a number of steps that sellers should consider implementing before going to market or engaging with potential buyers that will lend them credibility as a "real seller" and make them an attractive candidate for a deal.

Most sophisticated buyers will conduct a Quality of Earnings review (QofE) as part of their diligence to help validate add-backs/adjustments to EBITDA and justify valuation and sustainability of earnings, post-closing. Even if buyers will ultimately engage their own QofE, sellers demonstrate a level of seriousness and commitment when they make the investment upfront and provide an independent QofE report to potential buyers. It also helps sellers identify add-backs to EBITDA that might have been overlooked. This approach can lead to a higher valuation and provide insight into what level of normalized working capital might be requested as a working capital peg in the letter of intent or definitive acquisition agreement. Further, companies that historically had only internally prepared or accountant-reviewed financial statements should evaluate the cost and benefit of obtaining accountant-reviewed or audited financial statements, respectively, to make it easier for buyers to evaluate reliable financials with some degree of outside review.

Conducting an internal legal due diligence review is another step that helps lend credibility to sellers and, most importantly, can speed up the closing timeline. Many items such as ordinary course consents to change-in-control of material contracts are generally addressed after the LOI stage. However, certain items such as ownership/cap table records or real estate title defects with a long lead time should be handled in advance of deal talks to avoid delays. Other items such as environmental, benefits, sales tax compliance and other legal issues can be uncovered and addressed as part of a legal due diligence review.

Buyers don't expect to have every legal due diligence item identified, posted to a data room and covered off before the LOI — and they will certainly conduct their

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own independent review. Nevertheless, it makes it much easier for a buyer and builds trust when sellers are forthright with legal issues and propose solutions to address them via risk-sharing in the purchase agreement, transaction insurance, corrective action or other remedies.

If the internal legal due diligence review identifies material legal issues, then sellers should consider discussing potential transaction risk insurance solutions. While Representation and Warranty Insurance traditionally covers unknown issues in the event of breach of a rep or warranty in the definitive acquisition agreement, various tax indemnity and contingent liability insurance products can cover and ring-fence liability for known contingent exposure in the areas of tax, employee benefits, environmental and litigation matters. Again, when the due diligence issues are brought to the forefront and addressed (and not discovered by buyer's counsel or CPA firm late in the transaction process), it makes a deal more likely to close.

Sellers should also think about and propose to buyers what the business could look like post-closing, whether that be new opportunities and synergies or leadership and management if the primary owner of the business is going to be retiring or moving on to other things. These business items can enhance value to the deal, as many of the management/key employee issues are often addressed too late in the process. From a legal standpoint, addressing employee non-compete and employment or transaction/stay bonus arrangements at the appropriate time for employees to consider and evaluate — and not waiting until right before closing — is something that can often be overlooked.

Finally, sellers and the entire transaction team must establish reasonable and firm deadlines with all members of the transaction team and help hold everyone accountable once an LOI is executed. Despite what can be perceived as an adversarial situation, finalizing and closing a successful M&A transaction is more about collaboration among experienced parties, CPAs, counsel, bankers and other advisers.

Set weekly or daily status calls and meetings and establish agreed-upon closing timelines. Determine expectations for turn times on the definitive acquisition agreement and ancillary drafts. Confirm deadlines for review and resolve comments on environmental reports, insurance reviews, title commitments and other diligence items. These strategies are vital to keeping a transaction on track when buyers, sellers and advisers are working in a high-volume M&A environment.

*Dustin J. Vrabel, Esq., is lead partner of the M&A Group at Buckingham, Doolittle & Burroughs, LLC. Contact him at 330-491-5238 or dvrabel@bdblaw.com.*

# Valuation trends and expectations for 2024

**By Andrew K. Petryk**

2023 could be considered a year during which buyers and sellers took time to "catch their breath" coming off the frenzied pace of 2022. Market shocks of recession fears, persistent high-interest rates and geopolitical instability served to feed investor caution, leading many to hit the pause button on M&A and await better clarity on the macro environment.

The same catalysts that stalled dealmaking hold the potential to push deal flow higher and fuel a rebound in the M&A market in 2024. The weight of a threatening recession loomed large throughout much of 2023, yet the U.S. economy remained resilient. Economists predict continued, albeit slow, growth, with real GDP to increase 2.4% in 2023 and 1.7% in 2024. Interest rates are predicted to moderate or decline in 2024, with analysts anticipating a Fed Funds rate of between 4% and 5% by year-end.

The credit markets remain open for good companies. The debt markets have improved notably in the last few months. Spreads are tightening, although all-in rates remain elevated given where reference rates sit (three-month CME Term SOFR around 5.4%, and prime at 8.5%). Nuances remain in a market where new private (non-bank) lenders continue to emerge to fill voids left by

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the banks and syndicated markets, and alternative lenders are busy with mezzanine — an increasingly attractive financing option in the current environment.

The high-rate environment has decreased buyer leverage, putting pressure on valuations and causing a disconnect between buyers and sellers. As that gap narrows, we expect more movement in the M&A market. But make no mistake. Quality reigns and great companies are achieving great valuations. Business models with strong recurring revenue and free cash flow, consistency of performance through COVID, and

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insulation from geopolitical risk are garnering even greater attention. The highest-quality companies see virtually no change in purchase price multiples. While valuations remain strong for the best companies, the market is binary. Transactions involving average companies are difficult to get done today. Diligence requirements are heightened.

Signs of an uptick were visible during the third quarter. According to GF Data, valuations ticked up on middle-market private equity-backed M&A transactions, with the adjusted EBITDA multiple increasing to 7.5x — up nearly a full turn (0.9x) from the second quarter. Further, the year-to-date average of 7.3x falls just shy of the 7.4x observed in 2022.

Strategic buyers and financial buyers are sitting on cash, which will fuel the deal engine as acquisitions augment slower organic growth. Capital in the private equity coffers has ballooned to more than $955 billion as of the third quarter of 2023. More than 20% of that amount is tied to funds with a vintage of three years or more, which must be put to work. But while there is capital to be deployed, fundraising has been more challenging today, with the total amount raised by closed funds down 12.9% through the third quarter. Sponsors are choosier about which investments to support and are not rushing to deploy capital. The slowdown is not entirely unexpected, coming off a record year in 2022 when

U.S.-based funds raised a notable $381 billion, according to PitchBook.

Significant pent-up demand has the deal pipeline near bursting, with 2024 likely to be an "opening of the floodgates" as buyers, sellers and lenders await bringing deals to market.

*Andrew K. Petryk is a managing director and leads the Industrials practice at Brown Gibbons Lang & Co. Contact him at 216-920-6613 or apetryk@bglco.com.*