GETTING THE DEAL DONE - VENDORS PUSHING TRANSACTIONS THROUGH - ARAOZ & RUEDA

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Francisco Aldavero

Pedro Rueda

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If vendors are to achieve the multiples they demand in transactions they need to be more flexible in the way they look at deals and to be willing to help push them through

Tighter financial conditions, a lack of liquidity and difficulties agreeing transaction values are forcing companies to be much more creative in the way they structure deals, with a greater role being played by vendors to facilitate them, say Francisco Aldavero and Pedro Rueda, corporate partners at Madrid's Araoz & Rueda.

'Vendors continue to see significant differences in the company valuations they claim and the multiples buyers are either willing to pay or able to get financing for. What we are now experiencing therefore is the growing use of more creative deal structures,' says Aldavero.

Bank financing may be available but it is expensive and few are willing to extend purchase loans beyond 2.5 or 3 times EBITDA, he notes. 'In order for vendors to realise the perceived value of what they are selling they have therefore to bridge the gap. As such, many are now looking at deals in two stages, an initial cash-out and subsequent earnout.'

In some instances this may also require the vendor to part-finance the acquisition, although the banks involved are only willing to accept such deal structures if these loans are subordinated to their own 'senior' financing, says Aldavero. He notes however that such deal structures are not typical and to date have been preferred by those companies that already have private equity investors or are being sold to private equity funds.

'Sophisticated investors will take a much more pragmatic approach to deals and often recognise a value in retaining an interest in what they are looking to sell. But if a vendor wants to achieve multiples of seven or eight times EBITDA then this is currently the only way it can be achieved when equity and bank debt are not enough.'

Such deals may therefore have an upfront cash payment at an agreed valuation, which may be followed by an additional payment if specific performance targets are achieved, he says. In addition, transactions may also include 'drag along' rights by which minority shareholders are obliged to sell their holdings once agreed targets have been met, or the senior bank financing has been repaid.

'Vendors are exploring the use of 'earn-out' options which may also have a ratchet effect, utilising performance or equity bonuses to encourage the management team to reach specific targets and to justify the high deal multiples they claim.'

Industrial buyers have to date however proved less willing to go down such a route, notes Rueda. Many see higher deal values as justifiable only where they can exploit the synergies between companies which often means the merging of operations.

'From an industrial vendor's perspective there is less attraction in retaining an interest in a company in which you have little or no significant management control and that may not even exist in one or two years.'

The preference in such instance has instead been to provide greater flexibility to purchasers by accepting finance in instalments or through deferred payments, he says.

'There is less interest in structuring a sophisticated purchase as often the desire is simply to cash-out, to accept a smaller multiple and to walk away from a company. In any event there are evident challenges in enforcing any earn-out clauses.'

Lawyers, auditors and financial advisers all nonetheless have important roles to play in presenting such options to clients, believes Aldavero. 'If the vendor is sure about the value they are assigning to a company then it is often easier to agree a vendor's loan as a way of supporting their own projections.'

Nonetheless, this may require an extended deal timeframe. Not everybody is comfortable with deals that require longer exit periods and thus such structures inevitably lend themselves to those investors able or willing to take a medium-term view.

'The market has changed but perhaps there is an analogy that already exists within the real estate sector, where 'rent before you buy' schemes are growing in popularity, or where the banks are willing to give you a mortgage but only if you buy a property that they already own,' says Rueda.