Wire Harness Business & Strategy

Approaches to the Sale: Studies in Contrast

by:
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Whether you're a pro athlete looking to test the free agent market or a wire harness manufacturer looking to sell your company, dealing with competitive suitors is, quite obviously, an optimal situation. Less obvious is how to create competition.

Let's examine what can happen when you enter the sale process without an approach that ensures competition among desirable buyers vs. relying on an approach that does. We'll start with cautionary tales related by two old friends—whom I'll call Al and Bob—I encountered at a college reunion. Each had wanted to sell a USA-based manufacturing business in an industry similar to ours. We'll conclude with a much better outcome benefiting a client I'll call Charlie.

Al's Tale – Al had built a US$10 million-revenue business and was approached by a prospective buyer who proposed putting together the deal himself. Not only was the buyer coming forward with a fair price and terms, but he was also committing to retaining Al's management team—a key concern of Al. So Al signed a letter of intent (LOI)—a nonbinding letter specifying the price and terms the buyer would offer for the business after doing its due diligence—and he began involving his attorney and accountant in sale preparations. The expectation was that within 60 to 90 days, after due diligence, the deal would close.

Even though the due diligence did not turn up any untoward factors, the buyer used some due diligence findings as justification for modifications in price and terms. One adjustment would have been bad enough, but when renegotiations kept recurring, Al eventually halted further discussion. With no potential buyer waiting in the wings, Al had to put his sale and retirement plans on hold, and he was still in limbo at the reunion.

When Al asked for my input, I had to level with him. In the absence of a competitive sale process, what he had experienced was not unusual.

Bob's Tale – Bob's experience trying to sell his US$25 million-revenue business was different, but equally frustrating. He had been approached by a "buy side" broker who told him he had relationships with private equity firms that paid him to bring them deals. This sounded mighty attractive: no fees or other expenses and no preparation he or his team would have to contribute to the process. Because the broker was going only to trusted private equity firms, it appeared that confidentiality was not an issue, and because there would be more than one potential buyer, the process would be competitive. No wonder Bob concluded that this was an excellent way for him to sell his business.

However, as the broker continued to schedule conference calls with private equity firms, Bob realized none of them really knew anything about his business or the market he served. Consequently, he had to spend an inordinate amount of time educating prospective buyers about the basics of his business and the industry. And because all prospective buyers had been provided with his financials, Bob routinely had to field questions he was totally unprepared to answer, often finding himself on the defensive.

Over time, Bob recognized that the broker's criterion for selecting buyers was not industry knowledge—it was readiness to pay his fee. Moreover, none of the firms had in their portfolios any companies that might create synergy with his company. With nothing going the way he had anticipated, and no offers on the table, Bob's decision to terminate the process was an easy one. But what was not easy was resigning himself, like Al, to keeping the company and delaying retirement.

Do either of the approaches my friends tried ever work out? Sure, but not often. Without a competitive process among attractive buyers and without the involvement of someone who has a track record in your industry, a seller can waste valuable time without achieving the expected result. So now let's look at a recommended way to go.

Charlie's Tale – Recently, Charlie retained us to sell his US$25 million wire harness company. As is our custom, we began by throwing out a wide net, contacting an assortment of prospective buyers: manufacturers of wire harnesses, printed circuit boards and connectors; contract assemblers; and private equity companies. We then gauged levels of interest among the respondents and narrowed the pool to about a dozen serious prospects.

Our next step was asking each for an LOI, and we received three—each offering a price roughly 4.5 times the company's EBITDA.

The ensuing step was evaluating the candidates using nonfinancial criteria such as motivation. Granted, trying to determine a prospective buyer's motivation is subjective, but certain scenarios are generally dependable. For example, a wire harness manufacturer who wants to reduce customer concentration or a private equity firm that owns a wire harness company and wants to create economy of scale by acquiring another harness company would each appear to be truly motivated.

Now we were ready to make our number one pick and try to command a higher price. With our top prospect chosen, we delivered this message: "Several companies have submitted letters of intent, and we have decided we would like to put a deal together to sell our company to you. If you will provide us with a new letter within the next three days priced at a cash multiple of 5.5 EBITDA, we will sign your letter of intent."

This process resulted in our top-ranked buyer providing us with a letter of intent at 5.5 times the EBITDA, versus the original 4.5 multiple, providing our seller with a US$22 million purchase price—US$4 million above any initial offer (had the buyer declined to come in at that level within our three-day deadline, we would have gone to our next-ranked buyer with the same proposal).

Clearly, creating competition served Charlie extremely well, which illustrates a key reason to rely on an experienced M&A firm (broker) to manage the sale process. Unfortunately, many harness owners try to manage the process themselves, often selling to a buyer who just happens to approach them.

This is not uncommon for two reasons: 1) Owners of harness companies tend to receive a steady stream of inquiries from prospective buyers and firms who represent them. This can convince owners that selling is not difficult. 2) Often these inquiries promise deals that seem, to the uninitiated, irresistible. Owners who go down this road, without taking advantage of a competitive environment, almost invariably leave money on the table. *www.bluevalleycapital.com* **WHCC**

Author & Company Profile...

Loren M Smith is CEO and sole shareholder of **Blue Valley Capital LLC**, a position he has held since 2001. From 1976 to 2001, he was CEO and majority shareholder of **MWC**, a manufacturer of electrical wire harness assemblies. During that period, by acquiring and integrating a number of mid-market wire harness manufacturers, MWC became the world's leading supplier of electrical wire harness assemblies serving the construction equipment industry. Loren eventually sold MWC to a private equity group.

As CEO of MWC and Blue Valley Capital, Loren has spearheaded the sale and purchase of dozens of mid-market (US$2M-US$200M) manufacturing companies.

Early in his career, he was with **Texas Instruments (TI)**, rising to general manager of TI's connector division. Smith earned a BS degree from **Miami University** in Oxford, OH, USA, and an MBA from **Northeastern University** in Boston, MA, USA. **www.bluevalleycapital.com**