

How PE buyers can stand out in an auction process

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In today's intensely competitive deal climate, auctions are difficult to avoid.

With strong fundraising activity and seemingly unprecedented levels of dry powder, there is an abundance of private equity capital to be invested. Coupled with a limited number of deal opportunities, this has resulted in robust, if not overheated, market conditions.

From a sellers' perspective, initiating an auction process in this market can help ensure they're maximizing value and terms, and not leaving any money on the table.

But in such a competitive bidding environment, PE buyers should be strategic and proactive in their approach, including to help differentiate themselves and increase their likelihood of a successful deal.

Here are four strategies that can give PE buyers a competitive advantage in a typical auction process:

1. Build relationships

Active networking and ongoing relationship building can help PE buyers raise their profile and increase visibility among potential targets and their stakeholders.

When it comes time to consider a particular opportunity, it's important to make early contact; building strong and direct relationships with management, board members and other decision-makers. Ideally, this should be initiated well before an auction is on the table.

Having strong relationships with the target can help the potential buyer get earlier and more valuable access to information and/or people, potentially short-circuiting a full auction process. Those meaningful relationships, built at an early stage, also facilitate the transaction process itself.

The trust built during that courting period can go a long way in getting "selected" and successfully completing a deal. First learning about an opportunity or speaking with a target only when the process letter is issued is too late.

2. De-risk the deal for the target

In looking to stand out from a crowd of bidders, a PE buyer may have to make some difficult decisions to take on some of the risks that are typically covered in diligence or during the bidding process.

The due diligence process (including equity and debt financing arrangements and syndication, tax planning, post-deal integration and related matters) is time-consuming and sellers are always evaluating the probability of actually closing with a particular bidder and looking to streamline the bid and close process.

A bid will become more attractive to a seller if the level of due diligence and deal structuring required to complete the transaction is limited or reduced.

Limiting the conditions precedent to signing and/or closing (such as resolving third-party consents, regulatory compliance, business integration plans, equity incentive structures, etc.) makes an offer much more attractive to a seller. Having representation and warranty insurance and agreeing to no (or very limited) continuing exposure for sellers on indemnities and covenants is also key to de-risking a deal for a seller.

Mitigating the buyer's risk can be done in other ways including via post-closing covenants and by building in different types of pricing mechanisms or indemnity packages to the offer.

A seller will always assess the likelihood of closing on a particular bid, so dealing with these issues early tends to give the sellers very helpful comfort.

3. Front-load due diligence

Typically, most due diligence costs occur after exclusivity, once the bidder has some visibility of where they are in the auction process.

But instead of conserving resources until a deal appears more likely, a more assertive strategy for buyers is to front-load their due diligence. That means deploying real capital up front and investing more money early in the process.

Timely, more complete and time-efficient bids with less conditions will increase the chances of closing a deal, even if the offer is marginally lower than that of a competitor.

4. Shorten exclusivity periods

Longer exclusivity periods of 90, 60 or even 30 days are becoming less attractive for sellers, who want to close faster.

Instead, in conjunction with limited due diligence, buyers can become more competitive by asking for shorter exclusivity periods in their offers.

Sellers will often try to restrict this period, especially since a letter of intent does not bind the buyer to close the deal, so for a buyer, pre-emptively asking for shorter exclusivity helps mitigate the seller's risk.

Some PE buyers—that have deployed the strategies mentioned above and other mechanics that materially engage the target and its resources—have even been comfortable with de facto exclusivities and no written undertaking. This makes it easier for a target to engage in substantive exchanges towards a deal.

Conclusion

Auctions are becoming increasingly common as sellers look to leverage the best possible deal terms. In an effort to stand out against other bidders, buyers would be prudent to adopt and implement the strategies outlined above to potentially increase their chances of winning a deal.

***Note:** *This article originally appeared in The PE Hub Network.*