
ARAOZ & RUEDA**AUCTIONS ... BUYER BEWARE?**

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Much of the recent M&A boom across the Iberian peninsula has been driven by the significant increase in Private Equity (PE) activity. While international PE houses were seen to be raising the most interest in 2006, this year national PE houses and the mid-market are beginning to make a stronger impact. And with this increased activity has come a growing use of the auction mechanism by sellers, always eager to extract the highest price.

Market maturity

PE buyers prefer, of course, to develop proprietary deals by fostering relationships with owners and managers in relevant industries with the aim of pre-empting and auction. On the other hand, PE funds and other financial players are themselves sellers by auction, frequently to other financial buyers. Investment bankers or financial advisers representing company shareholders considering an exit will most likely also propose an auction. No longer is it the case that a potential buyer in the middle-market has a greater likelihood of finding and negotiating a deal on a proprietary basis.

A standard process

Controlled auctions have the seller, with the assistance of financial and legal adviser, preparing a "book" describing the business for sale. Potential buyers are identified and contacted and sign confidentiality agreements with the seller, or an advisers running the auction, before they review the book. Exclusivity is being pushed back in the process. Given the competitive landscape, buyers often have to re-bid to narrow down further the list or clarify orders.

Key elements

In this context, there are some elements that can be decisive in the auction process. From a buyer's perspective, an auction means lack of leverage and control over the process, competitive pressures to outbid other suitors and considerable time spent and expense incurred in evaluating numerous businesses while only occasionally winning the bidding process.

Thus, although value is value and bidders have become very aggressive in price, when evaluating competing bids, sellers consider other elements as much as they do price. Reputation and a track record of successful deals are critical as these elements can lead to raising a seller's comfort level with a specific bidder. Some bidders emphasize their commitment to the process from the early stages of the sale by ensuring they bring the right people to the initial management presentation and devote appropriate resources to the due diligence exercise.

For a PE firm, the company's management is also a key issue. If the buyer needs to keep the existing management, it should make the project more attractive for the management than the rest of the bidders. The buyer will also improve its relations with the seller if it manages to get

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it excited about the company's future after completion. Needless to say that, in this respect, PE firms are in a better position than strategic buyers as they can offer to key management participating in the transaction every ratio and ratchet on final exit, apart from other compensation packages.

A friendly approach to the seller's proposed SPA will also condition the impact on the seller's view of an offer. Reasonable indemnification periods and caps on seller's liability for indemnity and limited escrow amounts based on exhaustive due diligence and knowledge of the risks associated to the activity sector will also help sellers to choose among their potential PE acquirers.

Life beyond auctions

As a result of the bidding wars, we have seen that some PE firms are becoming more systematic in building contact relationships with investment bankers and the gurus of relevant industrial sectors in order to improve their deal origination sources and reduce their dependency on competing bids.
