

Weeding Out Bogus Buying Offers

As an owner of a merchant processing ISO, you most likely started your business with the goal of building and selling either your entire ISO or portfolio. You would be hard pressed to find too many other types of businesses that are conceived and built with an eye to selling from their inception. For this reason, the merchant processing arena is truly a unique marketplace, one where in the course of 3-5 years, someone who may have started their ISO in a spare bedroom, may now be looking at a multimillion dollar payday. There are more people who have fulfilled the American dream of building mini-empires in this business than any other business that I've encountered. As most folks have a "build-to-sell" mentality, it's a foregone conclusion that the one aspect of their portfolio or ISO that they want to understand is what type of valuation they can assign to it, which is most commonly articulated as a multiple of net monthly residual. It is with this in mind that I'd like to shed some light on truly being able to understand what constitutes a *REAL* offer, as opposed to a prospective buyer just throwing an unsubstantiated multiple at you in casual conversation.

There are three key components which are essential to every successful ISO or portfolio sale, namely **Price** (multiple), **Terms**, and **Ability to Consummate**. The deal won't happen if any one of these three components is missing. It seems obvious, right? You would be surprised. Time after time we listen to colleagues telling us that someone has made them a very aggressive offer as a multiple of net monthly residual, yet the structure of the deal, and whether or not that particular buyer has substantiated his or her ability to fund the transaction seems conspicuously ambiguous (at best), if not entirely absent.

I would like to challenge the conventional belief that an offer based on a multiple, whether it is made over cocktails or over the phone, is somehow a substantively a *REAL* offer. Too many times sellers hear a multiple and proceed to use it as a basis for a valuation, as well as a basis to try and solicit higher

and better offers. **Price** is only one component of a *REAL* offer and ultimately of a successful sale.

Without thoroughly analyzing the **Terms**, and the buyer's **Ability to Consummate**, which includes their track record of successful acquisitions and current funding source, the price offered is meaningless.

Here's an example (the numbers below are for illustrative purposes only): Let's say you are selling a "vanilla" portfolio – fully portable, primarily brick and mortar accounts, annual attrition less than 5%, not top heavy (the top 20% of accounts produce under 30% of revenue), throwing off a net monthly residual of \$200k. Let's assume that you've received 4 offers as outlined in the table below.

	Gross Offer	Multiple	Upfront	Paid in 12 months	Paid in 24 months
Buyer 1	\$7 million	35x	28x	7x	
Buyer 2	\$7.6 million	38x	16x	12x	10x
Buyer 3	\$8 million	40x	14x	10x	16x
Buyer 4	\$9 million	45x	13x	12x	20x

All of the offers are subject to maintaining revenue above some threshold attrition levels. Buyer 1 is offering the lowest gross multiple but the highest amount of cash up front. The first offer does not allow you to load in accounts to the portfolio in order to maintain your attrition requirements. Buyers 2 and 3 offer higher gross multiples but substantially less upfront cash, however they do allow you to add accounts in order to mitigate attrition. Buyer 4 may allow for bragging rights in terms of gross multiple, but it represents the least amount of money upfront with a payout that is very much weighted to the end of 24 months. Buyer 4 does not allow you to load accounts in order to maintain residual levels. Is there a clear winner? Isn't it obvious which deal is the best? Shouldn't the seller take the 45x multiple? I mean, it was the highest multiple offered, wasn't it?? You see the point.

What does it mean to get a high multiple if the majority of the money isn't seen for at least 12, 24, or perhaps even 36 months? Despite the tightening of the credit markets, there still are plenty of quality

buyers out there, however, some of the deal terms, specifically relating to structured pay-outs, appear to have stretched out in time.

Now let's talk about the **Ability to Consummate**. Has the buyer consummated a transaction(s) before?

Who is their funding source? A very funny thing seems to happen between the time buyers make casual offers, when they put together a term sheet, and when their finance committee gets ready to approve a purchase agreement. When people get ready to take out their checkbooks and pay for something it never ceases to amaze how things can change. Purchase agreements may and do look significantly different than term sheets. The finance committee gets to have their say before they release funds for the acquisition, and they may decide to "tighten things up". They might not change the multiple or the general terms – BUT they may decide to disqualify specific accounts within the portfolio based on performance over time. For example, if your portfolio has a measurable portion of non-processing accounts, as many do, be prepared to have them peeled out of the transaction or, at the very least, to take a significant cut on the multiple that was originally assigned to those accounts. You would think that these types of scenarios would all have come out prior to putting together the term sheet, but again when it comes down to the point where someone is about to write you a large check, you'll be amazed how many new issues arise. And of course, there are the offers from buyers who haven't consummated a transaction or from buyers whose funding source is questionable at best. I think we all know what those offers are worth. If the 45x offer in the previous example is from one of these "questionable" buyers – then the multiple is worthless. But regardless, sellers still choose to selectively remember the highest multiple from any party making an offer.

At the end of the day it all comes back to **Price** (multiple), **Terms**, and **Ability to Consummate**. Before you, as a seller, can begin to benchmark offers, you've got to validate the buyer's ability to consummate

and then try and compare the terms offered from other legitimate buyers such that you can ultimately work your way back to comparing *REAL* multiples – and hence, comparing *REAL* offers.

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