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Selling Your Creative Business – the buyer's perspective

In this series, Joe Lythgoe and Ayesha Chanda from our M&A team, talk to experts from across Lewis Silkin - sharing their top tips and valuable insights – about selling creative businesses.

This time, Joe and Ayesha sit down with Paul Rajput, our Partner and Head of the Corporate team. With over 20 years of experience handling transactions in the creative sector, Paul specialises in helping advertising and marketing companies through successful acquisitions. He shares his insights on the buyer's perspective in creative sector deals.

Ayesha Chanda: Hello and welcome to Lewis Silkin's podcast series, *Selling Your Creative Business*. This series is hosted by me Ayesha Chanda, an Associate in the Corporate team here at Lewis Silkin.

Joe Lythgoe: And me, Joe Lythgoe, a Senior Associate in the same team.

Ayesha Chanda: In this series, we'll be getting insights and tips from experts across the firm who all use their different areas of expertise to help creative businesses achieve their exits. Today, we're speaking to Paul Rajput, the Head of our Corporate team.

Paul has over 20 years of experience working on transactions in the creative sector, with a particular focus on advertising and marketing holding companies that have grown significantly through acquisitions. On this episode, Paul will be sharing the buyer's perspective on deals in the creative sector. Welcome, Paul, and thank you for joining us.

Paul Rajput: Thank you very much. Looking forward to it. I've heard some podcasts already, really enjoyable, and hopefully this is something that all our contacts and clients will enjoy listening to.

Joe Lythgoe: So, Paul, could you start by just telling us a little bit about the buy side work you do in the creative sectors at Lewis Silkin.

Overview of buy side work in the creative sector at Lewis Silkin

Paul Rajput: Yeah, so hopefully the people listening to this will know, but for those who don't, Lewis Silkin has been involved with the creative sector and creative sector clients for decades. And I've been working with them since I joined the firm as a trainee back in 2000, so well over 20 years. We've historically acted for, and we continue to act for a lot of the advertising and marketing holding companies, well -known names, many of whom are very acquisitive acquirers of agencies and agency -related businesses. More so now we're seeing acquisitions in wider digital space and technology as well from those holding companies.

So, I act for a number of those holding companies, undertaking their work, their M&A work in the UK. And that's whether they're acquiring a sort of a group of companies in the UK, or it's an international group that has a parent company in the UK. So, we advise on all of the legal aspects of that. And then for some of those clients, I also undertake M&A in jurisdictions outside of the UK where for a particular reason they may decide to use English law.

So, examples of that, of where I've done that in the past are Ireland, some of the Commonwealth African countries, Hong Kong, or occasionally the Middle East where it's not uncommon to use English law.

Joe Lythgoe: And does doing sort of those work with other jurisdictions where they're using UK law, does that create any sort of complications or is it as if you're doing like a UK deal?

Paul Rajput: It creates a complication in the sense that you obviously have a foreign law and so you need foreign law advice from overseas lawyers, but we're well placed to do that as a firm. We are a member of a couple of networks of independent law firms like ourselves. We have partners who specialise in advertising and marketing law, law firms similar to Lewis Silkin, and so we often regularly work with those trusted partners.

Ayesha Chanda: So, the focus of our series has generally been talking about the seller's perspective and kind of hoping that you can give some insights from the other side. And do you find that these kind of holding agencies do think about it more carefully if a target entity has a lot of offices abroad. Is that potentially ever a risk factor or?

Joe Lythgoe: What for not getting the deal complete?

Ayesha Chanda: Yeah, for not doing the deal.

Paul Rajput: No, I don't think so. These groups are international groups. They have businesses all over the world. They operate internationally and they're well used to having subsidiaries scattered around the globe. For them, buyers, holding companies in particular, they're looking for targets who meet the strategic fit, who achieve the objective that they need to achieve for that particular reason for that transaction. So, it may take a bit longer to do the deal, it may cost a bit more, but that's never really an issue from a buy side perspective. What they're looking at is the quality of the agency, the quality of their clients, quality of their people. And if they tick the boxes on those, they don't mind so much how complex or not the structure might be.

Ayesha Chanda: Okay. And I suppose maybe sometimes they might be wanting to build out in a particular jurisdiction anyway, and that would actually supplement their existing presence somewhere.

Paul Rajput: Yes, certainly in some of those overseas jurisdictions. In the UK, you know, they're all very well established. We're obviously a very significant player in, you know, globally in terms of creative economies, the UK is. And so therefore, you're right, but we don't see that so much in the UK. In the UK, they tend to be looking for additions to the skill sets that they already have.

Ayesha Chanda: Okay. And once the headline commercial terms are agreed between a buyer and the shareholders, from the buyer's perspective, what legal and non -legal hurdles do you see to getting the deal done?

Navigating legal and non-legal hurdles after agreeing on headline commercial terms

Paul Rajput: Many, of course. I can't list all of them, but just maybe the headline ones. On the legal front, I would say the structuring of the deal itself is quite important. And often heads of terms are not very detailed. They have the headline commercial terms, but they don't really set out the structure. So that's quite important to ensure, particularly from a tax perspective, from a seller's tax perspective, and from the perspective of getting a, you know, doing an efficient transaction previous to what you said. So, if there is an international element, it's important to think about that a little bit about how that's going to be structured.

Legal due diligence is another one. That's a really time consuming process, but an important one. And that can often be a hurdle if you don't do that properly. And then I would say on earn out deals, which 90% of the transactions in this sector are where sellers receive a payment dependent on future financial performance. The legal drafting around the balance between the control and the consolidation element that a buyer wants on such a transaction and the protections that a seller needs to be able to maximise their earn out. That can be a tricky negotiation at times. Sometimes that can be a hurdle.

Joe Lythgoe: And do you find it sort of helpful to sort of bash those things out early on, maybe at the heads of term stage in your experience? Or is it sort of, if you do that, is there a risk of, you know, getting too down a rabbit hole before you've even started?

Paul Rajput: I don't think so. Hopefully the sellers, in particular, are not so naive that they have not had advice either from their corporate finance advisors, from their lawyers, that these things are going to be coming down the track. If you do it too early, it is distracting. So, you have to do it at the right time. But eventually you get there and a lot of the buyers in the market use very similar strategies. And so, it's not unknown in the market about how these things pan out.

So those, I would say, are the sort of legal hurdles.

Ayesha Chanda: And Paul, just really quickly on legal DD (due diligence) for, obviously, founders that might not have gone through this before. From the perspective of these kind of advertising, marketing -focused holding companies, are there any particular areas that they tend to have a particular interest in, in terms of DD areas that you think sellers should do some more groundwork to prepare themselves?

Paul Rajput: Clearly any buyer wants to understand all legal risks involved and minimise those as much as possible. So, I wouldn't rule out any area more than another. But for these types of businesses, they're obviously people businesses. So, the diligence in relation to people is very important. The diligence in relating to the client relationships is very important because often as a buyer you're looking at those strong client relationships and ability to cross -sell into those when they get into the wider group. And IP can be very important because obviously they're creative businesses, many of them, and so understanding that is quite vital. So those are the three areas I would say is a lot of focus on.

Joe Lythgoe: And just, we're talking about the other day actually, but in terms of how many deals sort of fall over between that heads of terms stage and actually, as I said before, getting the deal done?

Paul Rajput: I don't think there's too many. In the 20 years I've been doing M&A, I would say I've had, out of the hundreds of deals that I've done, maybe four, five, six have fallen over, over those 20 years.

Joe Lythgoe: So, once you get the heads done, you're not home and dry, but you're in a good position.

Paul Rajput: Particularly if you're selling to a trade buyer, you're an owner manager, that chemistry, that relationship has already been struck up. The idea of the transaction and the synergies and the value adds to both parties is already there. Otherwise, you wouldn't be moving forward. So, unless something goes wrong during the course of the transaction, then it's very rare that they would fall over.

Joe Lythgoe: Sorry, I think we interrupted you about to talk about some of the non -legal sort of hurdles you come to.

Paul Rajput: Yeah, just a few little non -legal ones. I would say it's a very significant task as a owner manager selling your business and takes a lot of time and resource. So, just the lack of that resource, as well as running your normal day -to -day business operations, having to focus on the transaction, that can be a real issue.

Joe Lythgoe: And that keeps coming up, doesn't it? It's come up in most podcasts we've done so far. It's keeping you out of the business as you're going through this quite time -consuming process.

Paul Rajput: That's right. So, something to really think about from the sell side perspective, about how you're going to manage that. Buyers teams, obviously, they have often dedicated teams who do this, and that's all they do. And they're not people who are running the normal day -to -day business. Integration discussions are quite important, particularly how that agency is going to integrate into the buyer's group, what the reporting lines might be, how they will sit within the wider group. That's key for any seller, of course, as well as the buyer.

Ayesha Chanda: And is it basically 100% of the time that the agency's kind of remains as a standalone agency or does it ever get absorbed into the group?

Paul Rajput: That's a good question. You do tend to generally see agencies being left alone as a standalone entity or standalone group. And there are a few reasons for that. One is as we said, the vast majority of deals are done on an earn -out basis. So, it's much easier to have them stand alone to be able to calculate that earn -out. And two, often you're buying the people and the relationships, and you don't really want to upset those by significant changes from a buy -side perspective. But it's not always the case. Occasionally, agencies are acquired or management teams that form those agencies are acquired to be able to bolster an existing part of the buyer's group. So, there may be some integration there right from the beginning.

Joe Lythgoe: Okay, so interesting. I think we've talked previously on this series about sort of the priorities from the sell side in terms of getting the right deal on financial terms, as well as getting the right cultural fit with your agency and the business and a buyer. But from the buyer side perspective, especially on the legals, what are the sort of the key terms that are absolute must haves and tend to be sort of non-negotiables?

Key terms and non-negotiables for buyers

Paul Rajput: So let me just mention a few that come up very often. Non -competes and non -solicits. So again, people businesses, certainly as a buyer, what you don't want is acquire the business and those key managers, those key owners of the business move on very shortly after selling. So having that stick is quite important.

Joe Lythgoe: So that stops them going to settle for competing business or even work for competing business for a sort of set period of time?

Paul Rajput: That's right. That's right. And so, on the one hand, you have the earn out, which is designed to incentivise the sellers to stay. And then on the other hand, you know, you have the carrot, the stick, beg your pardon, which is the non -compete and non -solicit.

Ayesha Chanda: I was just going to ask what's kind of the standard time period for those?

Paul Rajput: It does vary according to who the buyer is and what they're general consensus is. Generally, how they do transactions around the world. Obviously, it depends jurisdiction to jurisdiction as well. But in the UK, you know, often you will see anywhere between sort of two and four years of doing the deal and potentially there may be further restrictions. If further shares are acquired

later, perhaps there's not 100% acquisition on day one, it may be a majority acquisition with further shares acquired later. So, they may be further covenants that are required on that second purchase.

Joe Lythgoe: It makes sense, right? Because from a buyer's perspective, you can't acquire a creative business which is all about the people and then they just immediately leave the day after, right? That's what I'm trying to avoid.

Paul Rajput: No, and very much that's not how deals tend to be done or structured for that precise reason. And often sellers, in my experience, sellers are not selling simply for the money. There is some greater objective, which is bigger geographical reach, being able to be part of a bigger group, being able to access skill sets, which they're not able to cross sell to existing clients. And so often sellers will actually want to remain for a few years post -sale and sometimes longer.

I think so that was non -competes and non -solicits. I think provisions around how the target will be integrated into and will be sort of co -aligned with certain aspects of the buyer's wider business. That's pretty non -negotiable for a buyer. Again, most of the buyers are fairly large, they have various group policies, some of them are listed. And so therefore they have to ensure that any target they acquire is co -aligned with those sort of wider business policies.

Joe Lythgoe: I suppose from a seller's perspective. I know we're talking about the buyer's perspective but anyway. From a seller's perspective, I think they have to accept that, right? But the main point from them is that they're not being treated any worse than any other company within the group.

Paul Rajput: That's right. But they need to understand it of course. You know, many of these businesses are quite fiercely independent before they sell, like to have the flexibility of doing things the way they do. So, it's just making sure they understand that, making sure that whilst they're part of a framework, they still have flexibility within that to operate their business how they want to.

Representations and warranties are probably the next one, which come up all the time. Of course, a buyer is buying the shares in a company, so it's a buyer beware, it takes the whole company. It needs to understand the unknowns. Obviously, buyers do diligence, they get a lot of information, but there are always some unknowns out there. And so having basic contractual protection in the form of representations warranties are important.

Business conduct provisions around running the day -to -day business. They're non -negotiable again. The buyer needs to know or have the ability to be able to control the business from a consolidation perspective, i.e., so from an accounting perspective, it can consolidate the results of that and therefore certain controls are required for that to happen legally and financially. On the other hand, the seller wants to maximise its earn out so it needs to know that it has the flexibility to work in the way which it wants to.

Joe Lythgoe: But typically, would you say the sort of default position is that the buyer has complete control of the company that's been acquired, subject to any specific matters that need the seller's consent?

Paul Rajput: Absolutely, because if you're buying more than 50%, then that's what you want. You want to have control of the board; you want to have control of not day -to -day operations but certainly the governance of the company.

Joe Lythgoe: And bigger decisions as well.

Paul Rajput: That's correct. And so, I'd say the ones that are non -negotiable probably are the non -competes and non -solicits. Non -negotiable in the sense that there may be some negotiations around timing and geographic restrictions but generally they need to be there and probably the provisions around how the agency that's being acquired needs to integrate with the buyer's wider group.

Joe Lythgoe: And I think you talked about talking about non -compete. So, I think there's some potential changes to non -compete laws in the UK. Do you want to tell us a bit about that?

Paul Rajput: Yeah, that's right. So, there's been some consultation from the current government about actually eliminating non - compete in the context of employment agreements in the UK because there are certain countries where non -competes are not permitted. Or certain other countries where the employer has to pay for non -competes. So that's not the case in the UK at the moment. That is not law. We have to see what happens with that. It's not certain whether that will proceed. Even if it does at this moment, it's just in relation to the employment relationship. And that is different from the relationship between a buyer and a seller where goodwill is being acquired, a payment's being made.

So, if that law does come in, it'll be interesting to see whether that eventually gets extended into shareholder type restrictions or seller type restrictions.

Joe Lythgoe: So definitely one to watch and it'd be interesting to see the impact on deals.

Paul Rajput: Certainly, and the buyers that we act for, they tell us that in certain jurisdictions they just can't do these things and so it's a bit riskier, they feel, for them. But if that's what the law is, then the buyer has to work with that and perhaps it might decide to structure the deal in a slightly different way.

Ayesha Chanda: Thanks, Paul. Are there any trends you've seen in recent years around what buyers are willing to accept or conversely, points on which they're taking a tougher stance?

Understanding buyers' flexibility and firm stances in deal negotiations

Paul Rajput: That's interesting now obviously again every buyer is different, and they perhaps take slightly different stance in different jurisdictions depending on what, you know, what we call market as lawyers often and then then argue over what market But I would say in recent years we've seen a lot more prevalence of what we call warranty and indemnity insurance.

So, this is where sellers can have an insurance to meet their liabilities under the warranties that they're giving, warranties and representations. So, I would say that buyers are much more willing to accept that now. Previously, they used to feel, well, if you're an owner manager, why would you not stand behind the warranties and representations you're giving? But as that type of product becomes more prevalent in the market, buyers are having to be more flexible on that.

And secondly, I would say, slightly technical point, but as lawyers we often argue around something called disclosure, which is the sellers being able to provide information in relation to the warranties that they're getting to make sure that they're not in breach of those. And often as part of the legal due diligence process, sellers will want to ensure all the documents that they've provided in that are generally disclosed to the buyer. And again, it depends on the market and the buyer, but we have seen that buyers are generally willing to accept that because they know that their lawyers have looked at those documents. So why would you not accept them as general disclosure?

Joe Lythgoe: Since you're talking about W&I insurance, because it seems like a sort of a win -win because the buyer gets the protection it needs and the sales get a liability. Well, they always seek to get a liability cap to a pound. Is it as good as it sounds?

Paul Rajput: I would say no. The devil is in the detail. It definitely does. It is a very good product and that's why it's becoming more prevalent in the market. But from a buyer's perspective, firstly, it increased costs. You have to do a lot more work if you engage some lawyers to help you with W &I. The lawyers having to deal with the insurer and the insurer's lawyers.

Secondly, it tends to increase time because there is a third party involved. It's not just a buyer and a seller, it's an insurer as well. And lastly, I would say there are a lot of caveats in these insurance policies. There are a lot of exclusions. And so, if a seller is simply not willing to give anything, often a buyer will have to take a view on those exemptions and caveats. And if the buyer is not, then it ends up being a bit of a negotiation again with the seller about the seller having to take on liability in certain areas and the rest is covered by the W&I insurance.

Joe Lythgoe: Yeah, of course there's always the negotiation around who funds the premium as well.

Paul Rajput: Exactly.

Joe Lythgoe: Okay, so we're asking everyone in this series, Paul, for one takeaway tip for a creative business looking to sell the next couple of years. What would your one takeaway tip be?

Paul Rajput: I want to give two if I can.

Joe Lythgoe: Everyone's asking for two.

Ayesha Chanda: Maybe we need to change our question.

Top tips for a creative business looking to sell in the next couple of years

Paul Rajput: I would say a seller and its entities within its group, if it is a group, certainly consider your group structure or your company structure, both from a shareholder perspective and from the structure of your subsidiaries if you're a group. And as much as possible, try to simplify that in order to actually avoid delays at the time of the deal. Now it may sound contradictory to what I said before, which is buyers don't really worry about these things too much. However, as a seller, what you don't want to look like when a deal starts is slightly haphazard, disorganised. Because that can then result in a bit of sort of lack of confidence from the buyer's side about the business and how you operate it.

The second I would say is to ensure you have your senior leadership team well incentivised, whether that's via some type of equity scheme, maybe options or other types of shares or other such like sort of shareholding structures. But equally make sure that it's

not overly complicated and requires a lot of work and advice and time at the time that any transaction might start because that can result in a number of weeks of delay and expense at the time.

Joe Lythgoe: Thanks, Paul. Thank you so much for joining us today. It's been really good chatting with you. And thank you to our listeners too for joining us. If you'd like any more information on anything discussed in this podcast, please get in touch with me or Ayesha and do look out for more podcasts in this series, *Selling Your Creative Business*. Our contact details are on the Lewis Silkin website, along with some other useful resources.

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