Mergers and Acquisitions
Part Three: Three Types of Acquisition Opportunities
by Wayne Einhorn and Norma Rawlings

This is article # 3 in a series of four articles on Mergers and Acquisitions in the Real Estate Brokerage Industry. In this article, Wayne Einhorn and Norma Rawlings describe three types of acquisition opportunities to assist anyone looking to buy or sell a real estate brokerage.

Real Estate Brokerages are changing hands at an unprecedented rate. Two factors are driving this trend. First, brokers want to retire as they become older. Second, the challenging market is putting economic pressure on brokers to either reach into their own wallets to fund their businesses if they can afford it or sell.

There are typically three types of brokerages to buy:

1. The Great Quality Going Concern;

2. The Poor Quality Going Concern; and

3. The Liquidation or Bankruptcy Transaction.

<u>The Great Quality Going Concern:</u>

The great quality going concern is your best brokerage on your best corner in your best town. It is a brokerage with a 25% or more gross margin. Even in challenging markets, it cranks out cash. It is typically stable with steady profitability and some cash in the bank.

We are dealing with one such broker right now, and he's done a great job between 2021 and 2022. His firm has remained stable, rolling into 2023. He's looking to exit his older partner and bring in a younger partner. That sort of brokerage is well positioned for a purchase or a sale. If you are selling at this point, and that's the type of brokerage you run, you are valuable.

As a buyer of the great quality going concern, the good news is that you no longer have twenty other buyers lined up to compete with you. For someone looking to acquire 50 great agents and grow their recruiting by acquisition, for example, your great quality going concern is a wonderful option.

Obviously if you're buying a business that in a challenging environment is doing a 25% or more margin, they have some good practices in place; they have some policies and procedures; they have good agents; they have stability; they have a history of success and a steadiness that you're happy to pay for because it will continue to do so in future if you continue to run it well. Hence it's not a matter of a discount price so much as more flexible terms for those right now. This is directly as a result of less competitors with the desire to buy.

We have a few of these on our desks right now. What is amazing is that the change year over year between 2021 and 2022 is less than five percent, which is incredible given that 2021 was a banner year and an outlier on all fronts. It is this stability and ability to churn out cash consistently year over year that you are paying for.

One of our customers runs a fabulous shop and is really top drawer. He does coaching, does training, does recruiting. He's fantastic. But he is 63 and he doesn't want to be doing this when he is 65. And that's completely understandable because he has been in the business for 40 plus years. So he runs that sort of shop where it is a great opportunity to acquire. The other nice thing about people like him is if they've had success and they don't need the capital piece up front, they are prepared to wait five years to earn out. When you're considering acquisitions, it's a wonderful situation to have a low down-payment up front. Buyers want that because you don't have to come up with a large down stroke. Sellers in that situation are often happy to act as elder statesmen, answer questions, and mentor younger agents to assist in the transition.

Interestingly, the great quality going concern may not be much cheaper than it was before. The key difference is that the deal structure is more flexible and you're not competing to bid for it. Taking that point of view there is a huge opportunity. Given your real estate experience, your best property on your best corner is going to be valuable all day long, and this type of brokerage is analogous to those properties.

<u>The Poor Quality Going Concern:</u>

The second type of transaction, where we are seeing a lot of volume right now, is the poor quality going concern. This brokerage has experienced a tough six months and doesn't have a lot of cash. What was maybe a profit last year is looking like a loss this year. The owners are pondering their options.

Those opportunities are plentiful this year because of the market. The overlying market drives our business. It drives the real estate brokerage business. They say that every ship goes up with a rising tide. Right now the tide is going down. Hence there are a number of poor quality going concerns available for purchase. A lot of brokers are in that position right now.

If you are sitting on cash or have access to financing, you can likely buy a bunch of really decent businesses with some good agents. These opportunities have arisen because of the challenging market. Those broker owners who weather this market and emerge into the Spring 2024 market where we expect improvement may no longer be interested in selling at that point. Right now, though, rather than pull from a personal line of credit to fund their business, they are open to selling.

<u>The Liquidation or Bankruptcy Transaction:</u>

The final type of transaction is the liquidation or bankruptcy transaction. This is immensely challenging. No one wants to go bankrupt, into receivership or suffer liquidation. If you are trying to buy such a brokerage, it is chaotic. You will be trying to recruit the agents of the failing business as will every other shop in town. There is little order or organization in such a transaction.

The challenge with running out of cash, as we all know as business people, is that you don't have options. All of a sudden you get shut down and your agents are untethered and it's a free for all. So that acquisition piece is very disorganized, chaotic, and hard to manage. Although the perception is that the bankruptcy situation creates “bargains”, you may actually be better off pursuing the first two types of transactions to truly grow and prosper. It is too difficult to try to control a bankruptcy or liquidation situation.

Einhorn was involved in the Corcoran Global Living Collapse. His clients acquired offices and space. They were able to pick up some managers. It was very hectic and chaotic and there was no certainty about outcome or the quality of what was being chased, signed and acquired. Although not a lot was paid, being some back rent and such, it is not ideal. In that transaction you are rebuilding the business.

Given the two trends driving transactions, there is a lot of opportunity for buyers right now in all three types of transactions. If you can purchase a great quality going concern with little money down, flexible payment terms, and with a seller who will stay to transition the agents and continue to help the business thrive, that is an amazing option. The poor quality going concern can often be picked up at a bargain price and for that reason is often attractive as well. The bankruptcy transaction is chaotic and impossible to control but if you can recruit some agents in the midst of the turmoil, good for you. In summary, opportunity abounds in this market and at this time.