Growth through Acquisition (GTA)

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1. Why consider Growth through Acquisition (GTA)?

Demonstrated organic growth is a solid sign of a strong company. Organic growth demonstrates that you have solid business model, you are competitive, and therefore able to dominate your market and take market share. But we believe all growth strategies should at least consider the path of GTA as well. GTA is a complimentary path to organic growth.

Opportunistic Buys

Baby boomers are now into retirement age. As a result, many are considering exiting their businesses. A recent survey projected that one out of every two businesses will transition in the next 10 years. Another survey estimated that most owners have 90% of their net worth tied up in their businesses and they are searching for a path to liquidity. This has created opportunistic buys.

A Better Business Model

If you have a better business model, there is an opportunity to acquire a business and apply your model to improve the efficiency of the acquired business. GTA could be a strategy for you even if your business model needs improvement. You may want to acquire a business that has a better model to improve yours.

Market Share

One way to acquire market share could be to slug it out with your competitors. In many cases, no one wins in this situation. Investing in new products, facilities, people, etc. can be expensive and can take years to implement. Another way to eliminate your competitors and capture their market share is to buy it from them. Buying market share increases your purchasing power, can improve your distribution leverage, can increase your market presence and importance to customers, offers the potential to up-sell or cross-sell products, adds services, further entangles the customers with your model, and possibly captures new customers in both existing and new markets.

Acquire Management and Capabilities

One of the biggest challenges to growth is management. Many small business owners simply do not have the management talent to grow their business. One way to overcome this is to hire the talent. But what many owners don’t consider is that you can acquire management talent. One of your acquisition criteria could be to target businesses with strong management which can be integrated into your business model. By doing this, continuity with the acquired company’s customers can be achieved while also bringing new talent and management capacity to the present business.

What should you conclude from these examples?

- Look for opportunistic buys where the owners are ready to exit
- Look for situations to leverage your business model and/or acquire a better business model
- Look for situations where you can increase market share
- Look for situations where you can acquire management and additional complementary capabilities

2. Why do so many deals fail to meet expectations?

Typically most deals fail because of poor integration after the deal is closed. In our experience it is easy to predict whether a deal will work. Below are a handful of reasons we have seen over the last 20 years as to why deals fail after close:

- Lack of a cultural and/or management fit
- The acquirer was not ready
- The acquirer moved too fast or too slow
- The acquirer was overconfident
- The acquirer did not put the right deal together financially

Lack of a cultural and/or management fit

This is by far the #1 reason deals fail. I was on the management team of a mid-market JIT distributor. We were acquired by a large multi-national. When we first talked to them, they were very impressed by the entrepreneurial culture of our company. They felt that if they could roll out that kind of culture within their existing business it would pay huge dividends. After they purchased us they decided to merge us with another complementary business of theirs. And they put us in charge; or so we thought. Normally, the acquiree is not in control. But they were so impressed with our culture, they wanted us to introduce it to their company. They said that, but their actions did not support what they were saying. Every time we wanted to do something that was out of the normal nature of their model, they fought us. They allocated overhead charges to us without adding any value diminishing our cash flow. They wanted us to present our actions to a committee and get "approval" before making any changes which slowed everything down. They would not let us eliminate duplicate and unneeded management driving up overhead. Within two years our entire management team had quit for other more interesting and productive endeavors. Needless to say, within three years of acquiring us the revenues of the combined entities had fallen by 67%. Customers started leaving because they could no longer get the kind of service and attention and speed with which they had become accustomed. The bottom line problem was that we had two very different cultures. One was very corporate and controlling. The other was very entrepreneurial. The two cultures could not merge and therefore no synergy was ever created.

The acquirer was not ready

Make sure you are ready before undertaking acquisitions. Be very clear as to what your objectives are and be ready to measure results. Make clear the benefits to all parties involved. Make sure your facilities, systems, and people are ready to scale for the increased workload and temporary interruptions of the integration. Make sure your cash flow needs and your funding requirements are clear. Create a contingency plan for the unknowns. Define an integration plan BEFORE you acquire the business. Speed is essential in integration. And benefits are not achieved until integration is complete. Make sure management responsibilities and decision-making parameters are clear. Determine how you are going to roll out the “good news” to customers and employees. Communication plans are essential. Make sure you understand the strengths and weaknesses of the business models for both companies. One of the successful techniques we have implemented is to first create COE’s (Centers of Excellence) which capitalize on the strengths of each company. And then begin to merge the two entities based on these strengths.

The acquirer moved to fast or too slow
Speed is essential. If you look at companies who have been successful with acquisition they all have at least one thing in common: they have a predefined process for integration. Successful acquirers such as Microsoft, Cisco, and GE all have a predefined method once the purchase offer is accepted. For two years I did nothing but integration work for a Fortune 200 company. Once the purchase offer was accepted, we swept into the acquired entity with a predefined process for integration. And, we usually had the entity integrated within three to six months.

Aspire’s methodology for integration breaks the process into two periods. The first period is the first 100 days. During this period don’t make too many changes. You want to let the entities settle in and get to know each other. Take this time to prove out your conclusions from the due diligence period and create your Centers of Excellence. Communications with customers, management, employees, and suppliers are key during this period. Anxiety will be running high. Needed changes will become clear in the first 100 days.

The second period lasts six to nine months. It is during this period that you start making changes. And the changes need to happen quickly and decisively. If your integration process, the benefits, and objectives are clear, and they should be if you prepared properly, now is the time to act. What we have seen in failed acquisitions is that the acquirer does not respect these two periods. They may make the acquisition and sweep in with change too fast. Or, in the second period, they take too long to make the necessary changes.

The acquirer was overconfident
We have seen some acquirers get overconfident; especially when they have had previous success. They do not respect the culture or business strengths of the acquiree. They do not listen. During the first 100 days it is imperative you listen and learn. You will learn things that you simply could not uncover during due diligence. You must incorporate these changes quickly into your integration plan. This is especially important when you acquire a company that is adding capabilities and new customers.

The acquirer did not put the right deal together financially
And lastly, the financial plan. Paying too much or paying too much upfront are common mistakes. We had an owner once that had a $3 million business. The owner wanted $1 million up front and wanted to remove working capital of almost another $1 million giving him $2 million at the time of close. The buyer gave this deal to the owner with the $2 million balance

of the purchase price to be paid out after three years. The buyer, a private equity firm, felt strongly that it was imperative that the existing owner stay on for at least three years. In addition to the $1 million paid up front for the business, the buyer had to put up another $1 million to replace the working capital so they were $2 million pregnant at the time the acquired the business. Shortly after the acquisition the previous owner's performance began to drop. After one year he was out. The mistake the buyer made was to assume the previous owner would stay and continue to perform to get the balance of $2 million due. But in reality, the previous owner, now with $2 million in the bank, began to focus on other interests. He was happy enough with $2 million and had enough capital to go do something else that was less stressful. The lesson here is that you have to know the true motivations of the seller. You also need to be sure you understand both working and investment capital needs. Infrastructure needs and complexity scale exponentially with top line growth. Be certain that cash flow needs are covered and you are not overleveraged when closing a transaction.

3. Can you share any examples of successful GTA strategies?

There are lots of examples of successful GTA strategies. All you need to do is pick up a Wall Street Journal or read the business section of your local newspaper. How do you think Microsoft or Cisco grow? Do you think they actually create all of the products they sell? Both companies have grown though acquisition. Many of their products were first developed by a small company which they acquired and integrated into their model. GTA has been and will continue to be the terrain for large companies and private equity. But it does work for smaller companies too. You simply need to deploy similar processes that the larger companies deploy. If done right, it's not as difficult as it seems.

4. Are we a good candidate for GTA?

You are a good candidate for GTA if:

- Your market is dynamically changing
- You have a business model that can be leveraged
- There are companies in your market with complementary services or products which can allow you to move horizontally or vertically and can be leveraged into cross-sell or up-sell opportunities
- You want to expand geographically into new or growing markets
- If you are in a declining industry and need to move into new markets
- You want to solidify your position in a consolidating market
- You have excess cash and working capital
- There are leveraged buy out opportunities in your market
- You have prepared a GTA strategy

5. How do we get ready?

Start by asking yourself these questions:

- How much change can you absorb without hurting the existing business?
- Can you dedicate 20-50% of your time to this?
- Are your people, processes, facilities and technology able to scale?
- Is your management team trained and ready?

- Do you have a GTA strategy prepared?
- Do you have an integration strategy and process prepared?
- Are your economics ready and do you have funding plan?
- Do you have a cultural plan ready?
- Do you have the expertise and if not, do you have a plan on how to retain the current expertise?
- Can you absorb the temporary expenses associated with the integration?
- How solid is your working capital position?
- What is your risk sensitivity?

6. How would we finance an acquisition?

We believe one of the main reasons more companies don't pursue this path is that they don't think they have the capital necessary to make the purchase. As we have stated previously, a lot of this depends on how you structure a deal. Many owners will consider seller financing and earn out situations. If your first focus is to maximize your current company cash flow, you may be surprised at how much ability you have to fund acquisitions right out of your existing cash flow. This is called "bootstrapping", where growth, organically or through acquisitions, is achieved by maximizing your existing company cash flow. Some common ways to finance an acquisition are:

- Private investors
- Bank financing
- Leveraged Buy Outs (LBOs)
- Earn outs
- Seller Financing
- Recap

7. How do we go about finding companies that are for sale?

It is estimated that there are 5.5 million businesses operating in the US market. Surveys indicated that one out of every two businesses will transition in the next 10 years. Only about 30% transition inter-generational. That means 70% of the businesses will liquidate or be sold to third parties. Most of theses businesses are not listed by an intermediary and are not actively listed for sale. Only 10% of business owners have prepared a written exit plan. More than 60% have done no exiting planning whatsoever. One of the most common comments we get from owners that approach us wanting to sell or exit their business is "I wish I had started this process years ago". Often they approach us suffering burn out, retirement, or a health issue and these issues have finally made selling a top priority. This creates great buyer opportunities, and the situation does not favor the owner. When an owner is approached with a "credible" buyer at hand, some owners will consider selling. That is why business owners are constantly solicited by business brokers and intermediaries.

Finding and qualifying these businesses is extremely time consuming. An existing business owner does not have time to search for acquisition targets. Our BIGS™ methodologies allow us to represent both buyers and sellers of businesses. For buyers, we take on the time-consuming task of searching, qualifying, developing term sheets, letters of intent, purchase offers, and assist with due diligence and integration on behalf of our buy-side clients. In addition to a constant pool of sellers approaching us, we run search programs and use our national network to produce acquisition candidates. Our buy-side program, called the Deal Review Process, was developed originally as a process to assist a private equity firm review 1,000 deals a year. We added a Formulate and Locate steps on the front end of this to create our Deal Review Methodology. This structured process typically produces acquisitions targets within three to four months and complete transactions within six to twelve months. Several factors addressed by the Deal Review Process are:

- Formulating an acquisition strategy
- Locating and qualifying opportunities
- How to approach owners
- How to approach banks and private investors
- Evaluating the deal
- Writing Term Sheets, Letters of Intent (LOI), and Purchase Offers
- Conducting due diligence
- Negotiation
- Working with attorneys, CPAs, wealth advisors, family, landlords, etc.
- Closing a deal
- Developing and assisting with integration

8. How do we identify good acquisition targets?

Finding good acquisition candidates is accomplished by completing the first two stages of the Deal Review Process.

Formulate

Our first step is to meet with a buyer and formulate their acquisition strategy. This usually involves one to two workshops where we work with the buyer to qualify and formulate their strategy. For synergistic buyers we perform a valuation and diagnostic on the buyer's business. This gives the buyer an understanding of what their business is worth prior to the acquisition, and allows them to then compare the valuation of the business after the potential acquisition is fully integrated. The diagnostic identifies core themes to improve profitability and grow right. Both deliverables give a good understanding of capabilities and strengths which allows us to run a very targeted search campaign.

Locate

The search process will yield sellers within three to four months. After meeting the owners and determining if they are a motivated, we will perform a valuation of the business and valuate and perform a diagnostic on the seller's business. The valuation allows us to benchmark the business against others in the same or similar industry and to our buy-side clients business. The valuation is the first step to determine whether or not to move forward. The owner has to be willing to sell the business at market value and agree to terms that work for both buyer and seller. The diagnostic identifies profitability and growth themes which create synergistic benefits and increase return the investment.

9. How do we perform due diligence?

There are various levels of due diligence depending on whether you are working from a Term Sheet, Letter of Intent, or Purchase Offer. Due diligence typically takes 60-120 days with the result either going ahead and closing the transaction or ending the pursuit.

Term Sheet

A term sheet is a document which spells out the terms of the deal. Often we like to have Term Sheets before expending time and money to perform due diligence. If we are in general agreement on terms, we will begin preliminary due diligence. This always involves signing a non-disclosure agreement. Preliminary information, such as an overview of the company, its history, management structure, and the financial and tax statements, is revealed. The owners of each business will usually meet.

Letter of Intent

Assuming the initial review goes well; the buyer then issues a LOI (Letter of Intent). The LOI is a non-binding agreement on the terms of the sale assuming due diligence will move forward. This document is significant to the seller even though it is non-binding to the buyer. It demonstrates to the seller that the buyer is serious and specifies that if due diligence goes well; the buyer "intends" to create a formal purchase offer which is binding. Additionally, we like to have an exclusive review period once a LOI is issued. This gives the buyer a chance to invest in due diligence and not have the business sold to someone else while due diligence is being conducted. This usually kicks off the formal due diligence process. Due diligence is usually performed in the following areas:

- Company and Legal Due Diligence
- Industry Due Diligence
- Financial Due Diligence
- Management Due Diligence
- Customer Due Diligence

Purchase Offer

Normally, a seller will not want to reveal details behind their strategy, management, suppliers or customers until a formal purchase offer is issued. Therefore, the buyer needs to be comfortable enough after completing company, financial and industry due diligence to issue a formal Purchase Offer. The Purchase Offer will contain several contingencies that will have to be cleared before the deal closes. This may involve additional financial due diligence, arranging financing, a review of leases and contracts in place, a review of the business strategy, and possibly interviews with customers and management. The customer and management issues are the most challenging because usually until this point the only people aware that a sale is pending are the seller and buyer and their representatives. Customers and employees including management are usually NOT aware of the potential sale. Both buyer and seller need to weigh the necessity to talk to management and customers. This is why we like to have integration and funding plans already developed so that if it is necessary to speak with customers and management, we can explain why the deal is moving forward and why it should benefit them.

This is a difficult and trying time for both buyers and sellers. Often, lawyers and CPAs from both sides are driving this process. Lawyers from both sides actually write the purchase offer. Usually, family considerations are also of importance at this stage. Aspire's job at this point is to coordinate with all the parties involved to keep the deal moving within a specified due diligence time period of 60-120 days.

Closing

Once all contingencies are cleared, including the funding arrangements, the deal formally commences, money is exchanged, and the deal is closed.

10. How do we integrate the acquisition?

There is a tendency to let down after the deal closes and there is danger in this. The first 100 days begins at deal close. Announcements need to be made and it is imperative the action deemed pertinent in the first 100 days begins immediately. In some cases, buyers will continue to engage us to coordinate the integration process and help implement the value enhancements previously defined in the initial evaluation of the acquired business.

Conclusion

Acquiring a business can produce significant returns on investment. For synergistic buyers, acquisitions are a key tool to rapidly scale a business and can deliver significant growth in market value – when done right. But it is not for the faint of heart. It can be a very trying experience and emotions usually run high; especially from the seller's side. It is important for buyers to understand this emotional side of the seller and understand that the seller's behavior is not always rational during this process. Since we represent so many sellers and are certified in the exit planning process, we are very sensitive to the emotional and psychological aspects that sellers experience when the reality hits that they will no longer own and operate a business which many of them founded. We use this experience to create win-win situations for both buyer and seller. And we have proven that this approach produces significantly better return on investment in the long run.

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