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BUSINESS SALES
ACQUISITIONS
STRATEGY

Guide: Acquisitions

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As a company owner maximising equity value is of utmost importance, acquisitions can be a key way of accelerating the business especially when organic growth is difficult. Careful planning and implementation is critical to successful acquisitions, without strategies in place the risk of failure is high. This guide aims provide you with an insight into the process of successful acquisitions.

1. Planning

Is Acquisition Right for Your Organisation?

Acquisitions are an important route for companies to keep pace with emerging trends in the market, they can also drive shareholder value. The best acquisitions combine economies of scale, synergy and an overall uplift in the combined shareholder value. This means acquisitions are a vital component of business strategy.

Increasingly companies are acquiring to build stronger brands, enter new global territories and gain innovation expertise or intellectual property. Organic growth or competing are always alternative options for buyers, although in a slow growth environment acquisitions appeal because they are faster. Competing may simply not be an option where the seller has effectively built a brand and secured market loyalty that creates a barrier to gaining market share, acquisition may be the only way to build scale. They are however technical and require robust strategy to ensure success. With expertise and planning acquisitions can be an extremely accessible and exciting way to build scale however, the statistics below demonstrate the importance of having a well thought out and implemented plan:

- Only 23 % of all acquisitions earn their cost of capital with only 30% achieving their forecasts.
- In acquired companies 47% of executives leave within the first year and 75% leave in the first three years.
- 1/3 of acquisitions achieve an increase in shareholder value, a 1/3 destroy value and a 1/3 do not meet expectations.
- In the first four to eight months following a deal productivity can be reduced by up to 50%.

Sources: PWC, Wharton Management School, Watson Wyatt Worldwide.

For all the challenges there have been some hugely successful transactions both small and large, the rewards can be immense. In the public arena Disney's purchase of Pixar transformed their technology approach. The Exonn Mobil merger bringing £2.8 billion in near term operating synergy to create the world's highest market cap value oil business both then and now, as well as providing technology enhancements upstream. A good acquisition strategy is a result of a clear internal objectives combined with forward-looking due diligence that secures the right targets, terms and integration.

Acquisition Strategy

As a business owner if you are thinking about acquisition you should think about creating a growth strategy plan with clear objectives: Is acquisition is the best way of achieving these? What are your other options? Organic growth, further investment, improved processes, improved marketing? After deciding acquisition is the way forward, you will need to start planning to ensure success.

The first steps before defining your target criteria is to be sure your company is best equipped to facilitate a successful acquisition, ensure that:

- Your growth strategy is clearly defined so you do not stray from your original objectives and timescales. It is easy to be swayed by the attractions of an acquisition; the same way you might look at a menu and choose chocolate fudge cake when your goal is to lose weight.
- The organisation (HR, IT, finance, management, systems and processes) is adequately structured to facilitate a successful merger with another company. Can you support new staff and systems? Is your existing structure coping with your current set up? Do you need to make changes?
- Capital investment requirements and funding facilities are realistic. Investigate these before launching into an acquisition project; you don't want to fall at this hurdle later down the line.
- Internal or external resources are in place to facilitate the acquisition and subsequent integration.
- You and your advisors have the skill to target the right company and the technical expertise to structure terms correctly and undertake the process.
- You and your key management team are personally prepared for the required investment in time.

Defining the Acquisition Target

Defining the acquisition criteria is essential, it will also help you stay in line with your objectives and more easily identify those matching your requirements. It can be helpful to think of companies that would be a perfect fit in an ideal world, consider:

- Synergy/Economies
- Sector/Location
- Client Base
- Strong Assets
- Export
- Premises
- Effective Staff and Management Team
- Assets/Equipment
- Turnover/Profit
- Contracted Revenue
- Purchase Price
- Cultural Fit
- Sustainability and Risk

Prepare a checklist of these items and grading each company you consider, this will assist you in decision making (An example of a form is included at the end of the document). Keep in mind; what overreaching strategic benefit will our ideal target give us? How will the acquisition give us a return and help us reach ahead of our competition?

2. The Process

Identifying and approaching targets

Targets can be identified from a variety of sources including: trade, internet, customers or suppliers. Compiling a list of potential targets is essential along with research.

To be one step ahead of other competitive acquirers it is worth considering appointing a 3rd party advisor. They will utilise extensive intelligence resources and relationships in the global mergers and acquisitions community to ensure that "hidden" sellers as well as active sellers are identified. This provides you with a greater quantity and higher quality of acquisition prospects, reduced research and management time with increased success rates.

After producing you're your target list the next step is the confidential approaching of the targets. Potential sellers need to be handled delicately in order to insure ease of co-operation. To use your time effectively it is wise to have telephone conversations to eliminate unsuitable parties and produce a high quality short-list of targets to meet. At this stage all conversations should be protected by a non-disclosure agreement.

After you have ascertained they match your initial criteria, detailed questions to ask prior to meeting could cover:

- Up to date financial figures including P&L performance for last three years.
- Type and location of clients and client value/split.
- Type of work undertaken/contract base.
- Staff numbers, roles, locations and length of service.
- Premises details, locations and expiry of leases etc.
- Details of owner's role, profile age and view of on-going involvement should a sale occur.
- Copies of any literature and copy of standard terms of business.

Business Valuation

It is important to understand the principals of business valuations as well as the complexities of deal structures (Or that your advisors are able to facilitate this) prior to meeting potential sellers. It is essential to have a clear understanding of what you are buying to ensure that the value of the combined business exceeds the value of your existing business plus the price of the acquired business.

There are many valuation formulas such as asset based valuations, discount cash flow forecasts, intellectual property and dividend formulas. However, typically in unquoted businesses the most usual method is to use a multiple of one year's "adjusted" and sustainable profits. The chosen multiple is the number of years it is considered acceptable to generate a payback on the investment. This will typically include the balance sheet at enterprise value with surplus cash and freeholds extracted from the value. This can be expressed as:

Multiple x "Adjusted" Maintainable Profit per annum pre-tax = Likely Valuation

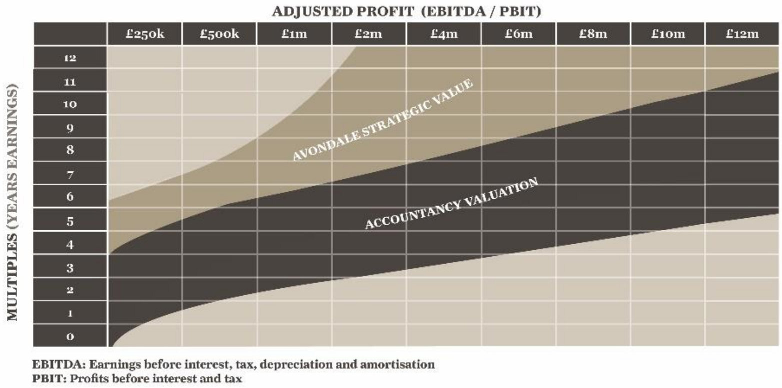
The value of a business is dictated by what a buyer is prepared to pay and a seller prepared to accept. As a buyer the potential economies of scale and synergy can influence what you are prepared to pay. A valuation will seek to measure the trust the market has in a business and its ability to create wealth (the goodwill). Goodwill is intangible, although the accounting definition is the difference between the purchase price and the company's balance sheet assets (net assets).

An adjusted EBIT or EBITDA may be used depending on sector. This is calculating the earnings before interest and tax (EBIT) or depreciation and amortisation (DA). This can include items such as salary or extraordinary or personal costs. Adjustments to the net profit might include 'add ons' such as costs for placing the business under management, additional premises cost if requiring relocation and investment required replacing old equipment.

Multiple Influencers

Low multiple	**High multiple**
Volatile	Sustainable
Less Desirable SME Business	Highly Expandable
Poor Expansion	Growth Sector
Declining Sector (Poorly Perceived)	Bigger Profits
Lower Profits	Strong Team
Poor Infrastructure	Recognised Brand
Low Economies	Growth Record
	Intellectual Property

Multiple Range: Below is a typical guide to the 'assumed' multiple range x the adjusted profit. The profit is usually expressed either PBIT for service companies or EBITDA for capital intensive businesses such as manufacturing. The table assumes a debt free/cash free balance sheet included in a deal, excluding freeholds. Aspiration value should always be sought to secure transactions beyond the multiple.



Deal Structures

There are many types of deal structures, for full information please see our guide. Ideally as a buyer the best scenario is to be putting down as little cash as possible and sharing the risk with the seller.

There are several ways in which this can be completed including deferred payments, performance related payments or earn outs. You can for example structure the deal on 20% cash up front 80% spread over 4 years in no-interest notes, you can also make the deal performance dependent. A professional advisor will be able to provide guidance on the optimum deal structure.

Viewing Meetings

After you have ascertained you could benefit from the synergy, it is time to meet the owner(s) of the target company. The objective of the meeting is fact finding: Does the business fit your requirements? Do I want to buy from this person(s)? But, of equal importance is whether you are both able to work together to ensure a smooth handover. It is important that you establish a good relationship with the owner early on, this will help secure a transaction.

Bear in mind that the seller will have as many questions about your organisation as you do about theirs. Avoid over selling the opportunity, take a consultative approach and leave the seller wanting to know more. The meeting should be concise, prepare and present the top five realistic opportunities and the reasons behind them.

After the meeting carefully analyse the information acquired and work out whether you should progress the opportunity. Consider items such as:

- Does the company meet your acquisition criteria and your strategic growth objectives?
- Is there steady recurring and forecastable income?
- Is there dependency on key members of staff, clients and suppliers?
- Are there good IT and finance systems in place?
- What are their long-term strategic goals for growth?
- Is it a cultural/physical fit?
- Would the business integrate well?
- Is it in the right price bracket?
- Will funding be available?
- How does it compare with other targets?

Negotiation Techniques – 5 Top Tips

A successful acquisition requires careful planning, good timing and an effective approach. Negotiation plays a key role in achieving your objectives and preparation is crucial to success. Understanding each party's unique deal motivation gives you a distinct advantage. Also understand your own goals – what do you want to win and what can you afford to lose?

1. Think Four Moves Ahead

By understanding the other party's motivation you are able to create a strategy, anticipate any moves during the negotiation and react accordingly. It also enables you to be proactive and lead the negotiation to achieve your goals. Think like a good chess player – several moves ahead of your opponents.

2. Listen, Assess the Personalities

Following on from the point above it is critical that you listen, assess and react to each of the personalities involved. What is driving them? What do they respond better to? Do they need facts? Do they need an intuitive feeling of reassurance? Walk in their shoes – think like them. Working this out will put you in a powerful position.

3. Win the Big Points/Lose the Small

Establishing your desired outcome prior to negotiation will enable you to understand what you can afford to lose and what you need to win. Losing on smaller points and focusing on your win gives the other party a feeling that they have won in some form. Fighting for every point will end in a stalemate at best.

4. Be Non Adversarial

Operate from a "charm" position focusing on win-win with objective criteria. Show respect to the other party to avoid creating an aggressive negotiation battle. What you are looking to achieve is for both sides to leave, feeling that they are getting what they wanted, or are at least far better off than when they went in.

5. Operate from a Position of Strength

Understanding and importantly believing in your true worth both today and in the future is crucial to winning your battle. You need to have strategic contingency plans in place for the next few years. Being clear on your alternative strategy to grow the business creates a powerful walk away position to leverage your negotiations and to optimise as well as justify your sale price.

The Transaction

After agreeing a purchase price and deal structure you now move into the legal elements of the process. At this stage it is essential to employ the services of a lawyer with M&A experience. The first step is in-depth fact finding and due diligence, this is to make sure that the transaction is based on fact rather than assumption. This will cover marketing, financial, legal and cultural (HR).

Legal and financial due diligence should be treated with utmost importance. Legal due diligence covers the structure of the target company, employment issues, I.P rights and legal compliance. Financial due diligence on the other hand provides an independent review of the information provided by the vendor. This should include: historical earnings and profits, the customer and product mix, future prospects, bad debts and creditors, pensions and tax liabilities.

The next step is to produce binding contracts that describe the agreement in minute detail. Be wary of just looking at the financial aspects in due diligence and use the exercise to build both a check on what you are buying as well as developing business plans.

Most of the money in a purchase is spent on technical aspects but many transactions fail around people so consider investing in cultural due diligence and customer relationship checks. There are experts that specialise in both these services.

Agree upfront who will pay if the deals cancelled, it is acceptable to expect the vendor to pay the majority of fees if the deal fails due to problems pinpointed in the due diligence. For information on the legal aspects of the process, please see our guide – Legal Aspects of a Business Sale.

3. Acquisition Integration

Effective acquisition integration is critical to success and return on investment. Frequently, it is at this stage that mergers struggle or fail.

An integration plan need not be complex but it is essential to cover all areas. A team will need to be put together to ensure that nothing and no-one is overlooked, it should be made up of experienced decision makers (although it is worth considering high potential enthusiastic junior staff) in both organisations to provide knowledge share and encourage co-operation, ensure that all departments are involved.

Early investment in integration resources will ensure clear understanding of risks, issues and enable realistic planning. The process is complex and it may be worth employing a 3rd party advisor to assist you. Not only will they have in-depth acquisition experience but they will also be able to view the merger from a neutral standpoint.

Integration Plan Check List:

- Put together an integration team.
- Constantly review progress and lessons.
- Define your integration objectives, revisit your growth strategy plan.
- Assess risk – what could go wrong? Incorporate risk prevention into your plan.
- Put together a prioritised action plan stating who does what by when.

A constant review of progress and incorporating lessons learnt is essential throughout the process).

Items to Consider

Motivation is key to a successful change in management and integration. Be transparent about the entire process. Communicate your plan keeping everyone constantly informed so that both new and old, know what is planned and reassured wherever possible. Be aware as the process develops their perception of the transaction will change and therefore you may need a lot of 1-2-1 engagement. Questions to consider might include:

- What are the cultural differences between the organisations and how are we hoping to effectively fuse these.
- Systems – IT/HR/Finance/Legal – how will they integrate? Do you need to upgrade given the larger organisation?
- What needs to happen to branding and values
- How will the customers perceive the change?
- What impact will the acquisition have on the supply chain
- What will happen to production, technology and R&D
- What will happen to locations, premises and equipment?
- Is the new company more attractive as an employer?
- How much do people see the benefits to the acquisition and how can this best be shared in a constant way?

- How can you share the background to the deal? Was the move hostile or welcomed?
- What is the level of surprise about the merger or acquisition?
- What can the leaders do to aid the transition?

When acquisitions or mergers occur people look to their leaders and managers for insight, help, answers and reassurance. They need to know and feel that those in authority have a strong understanding of the issues, that they care and further they have a clear sense of the direction required particularly at each level of change and offer announcements as outlooks change:

People take time to get used to the idea so first they 'close', then they start to accept the fact that things are changing and there will be many new challenges. They then move to 'uncertain' and watch and listen before committing to the transition, ideally moving to 'engaged' and active mode where they become excited by the future.

Leaders will invariably be more informed and thus ideally or typically be in the 'engaged' phase and they can forget that this is not where others will start. In all probability, their sense of excitement might not be shared by employees, who will react with a sense of loss and uncertainty. Sometimes it can be vital to employ strategic experts to both aid and assist in the communications and the integration plan. Not least of which this increases the resources available to get the fusion right. The classic team building single day out is to be entirely avoided, in favour of creating deep quality time situations to allow people to get to know each other and takes away fear, build rapport and trust, giving people the opportunity to voice their thoughts, hopes and concerns throughout the process.

Summary

Acquisitions can sit at the heart of effective business growth strategy. Done well, they will offer new territories expertise and scale that can accelerate both profits and shareholder value. In the current climate it offers a viable alternative to organic growth. Careful planning at every stage and the committed skilled resource is however critical to success. If you would like to find out more about the process or to discuss your objectives, contact us on 01737 234892 or iod@avondale.co.uk.

About Avondale

Established in 1991, Avondale provide unrivalled award-winning business sales, mergers and acquisitions transactions and strategy growth solutions with the highest success rate in the industry.

Avondale have genuine business acumen and are not only able to provide outstanding transactions but also practical solutions and guidance to achieve, if not exceed our clients' expectations.

Our work is predominately obtained via recommendation, a reflection of our technical abilities, strong service ethos and principles led approach.

Acquisition Criteria Form (To be tailored to exact requirements)

Acquisition Details	
Location Sought?	
Sector Sought?	
Client Base?	
Export?	
Premises?	
Management Staff?	
Staff?	
Assets/Equipment?	
Turnover/Profit?	
Contracted Revenue?	
Purchase Price?	