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Keys to Successful Buy Side M&A Transactions

By Mark Capaldini and Paul D. Economon

Many investment bankers believe that buy side M&A transactions are more difficult than those on the sell side and that such projects have a substantially lower probability of closing. Therefore, they avoid these engagements altogether. While their concern is warranted in many situations, it arises from problems that, while understandable, can be addressed and avoided.

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The biggest problems in buy side M&A engagements often arise from a lack of clarity and discipline, and they generally fall into two categories: tactical problems and organizational commitment.

Tactical problems have both financial and non-financial origins. An example of a non-financial tactical problem is oversimplifying the strategic challenges faced by the prospective acquirer, such as lack of new product or service lines. The acquirer mistakenly concludes that an acquisition will “fix” what is actually a much more fundamental problem, such as the lack of a competent sales force and/or a desired customer base.

Acquirers focusing heavily on increasing their desired customer base have a greater chance of success in their M&A engagements. Such focus causes them to address fundamental strategic challenges and to place the proposed acquisition in proper perspective.

Another tactical problem is the acquirer’s lack of clarity on “cultural fit” issues. Many acquirers fail to recognize and communicate the specific values, goals and operating philosophies which are bedrocks for their organizations. In those instances, the seller may not understand the non-economic value of consummating the transaction, and/or the buyer may underestimate post-acquisition integration issues arising from clashing corporate cultures, such as when a defense contractor acquires a commercial entrepreneurial organization that is used to quick decision making to capture market opportunities. On the other hand, when the acquirer clearly express these “soft considerations” in their initial communications to the seller, these considerations often become key attractions to the seller throughout the transaction process and act to “sell the seller” on why a transaction is attractive.

Tactical financial problems arise when acquirers fail to assemble a team of M&A professionals in a timely and thoughtful manner before they begin their search. Not only do acquirers need an internal team of senior executives and corporate development specialists, they should also retain seasoned, outside advisors before they begin the acquisition process. Examples include advisors with various areas of expertise such as funding, accounting, tax, legal, M&A transaction intermediation and financial planning.

Without such a team of M&A professionals, acquirers have less chance for a successful transaction because they do not define acceptable: (i) minimum and maximum target sizes; (ii) EBITDA ranges as a percentage of sales; (iii) mini-

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mum and maximum purchase prices; (iv) financing sources, such as internal cash or stock, external debt sources, or earn-outs; (v) transaction structures; (vi) tax consequences; and (vii) contingent liability situations.

Having an experienced team in place can also help acquirers develop the financial metrics and analytical tools necessary to examine the implications that a buy side M&A transaction may have on the company's income statement, balance sheet, and cash flow statement. The team may also assist the acquirer in developing a ranking process for the targets. An acquisition team sharpens the acquirer's decision-making process so it does not lose attractive deals because it cannot promptly evaluate sellers.

Organizational commitment originates from the acquirer's overall strategy and often from its CEO. M&A should be an integral component of a coherent corporate strategy, not a replacement for strategy. If M&A activity is not specified in its growth plan, such as a key project with milestones that the CEO articulates with specific revenue, headcount and/or customer expectations, then the acquisition strategy is likely an "experiment" and destined to fail.

Most CEO's can and do delegate substantial work to other senior executives during any significant transaction. However, when he or she is not directly involved in a buy side effort, both in process oversight and direct interaction with the target "in the later stages," the process has a much higher risk of failure.

The acquiring company must understand and be committed to the process, as the time required to identify, contact, meet, analyze, filter, negotiate letters of intent with, perform due diligence on and then execute definitive agreements with targets can feel like a marathon. Process fatigue can occur, especially if parts of the process are repeated with numerous targets. It is not uncommon for this process to take six months or more. The acquirer, its CEO, executive management team and Board of Directors must have the stamina and a deep organizational commitment to endure this ongoing process with their external M&A team.

Note also that one qualified target is not enough — two to four viable targets are typically required for a buy side M&A project to succeed. All the key players must have realistic expectations about the process and the decision-making roles they will play, if any, to avoid unexpected and disastrous eleventh hour "commitment" issues.

The characteristics that successful acquirers often share include: (i) a strong, closely coordinated team of executives and external advisors; (ii) attention to the "tactical problems" of transactions; (iii) strong "organizational commitment"; (iv) a realistic and detailed project plan, with key milestones and time frames for rapid decision-making; (v) a comprehensive system for the research and identification of potential candidates (usually over 100), so that the widest possible net is cast to identify the most suitable targets (usually 2 to 4); (vi) an approach methodology that neutralizes the "noise" surrounding frequent inquiries made by various intermediaries; and (viii) a clear plan to identify and engage sellers who may not have initiated a sales process yet.

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