Sell Your Company as an Add-On in this Uncertain Market

Getting the Deal Done

John Hammett, Managing Director
Minneapolis Office
Corporate Finance Associates

This may not seem like the right time for most owners of $5 to $50 million companies to be selling. But if the selling company is positioned as an Add-On to a bigger company, owners will be surprised by the interest in the deal, the valuation, and the terms of the deals that can get done. Add-Ons or Bolt-Ons or Tuck-Ins are deals where a large company buys one or more smaller companies in the same, or similar, businesses to accelerate their own growth. This strategy drives a lot of buyers to make acquisitions. Being an Add-On acquisition can be a real plus for the private company owner being acquired. Many of the stumbling blocks that interfere with other kinds of merger and acquisition activities are not a problem for these kinds of deals. Here are a couple of advantages for sellers:

Less Industry Due Diligence

Add-Ons are done in the same or similar industries. The buyer doesn't need to go through a long learning curve to understand the seller's industry and markets. The owner doesn't need to spend time convincing the buyer it's a good industry; the buyer already knows that.

Less Business Due Diligence

Because the buyer is in the same or similar industry, they understand the company's operations, methods of business, and accounting systems. If they think that they know even more than the seller that's even better, because they will believe that they can add more value after the deal. More Cash At Closing In Add-Ons the selling company is typically much smaller than the acquiring company, so often these transactions can be done for straight cash. If the buyer needs to borrow money to get the deal done, the borrowing is done by the acquiring company. It is less common for the seller to be asked to take some of the payment in **seller paper**.

Less Need For Management Continuity

Add-Ons pay off for buyers when they can consolidate them into their own operations. This means that the selling management team is less critical to the success of the deal for the buyer. Many deals don't require the selling management to stay on after the closing.

Less Contingent Payments

Because the management usually leaves after the sale, and because the buyer believes that they know the market well, there is less justification for the buyer to ask the seller to take some portion of the deal in contingent payments (earn-outs). Dealmakers classify buyers as either Strategic Buyers or Financial Buyers. Both types are active buyers for Add-On deals:

Strategic Buyers are companies in the same or similar industries who make acquisitions for a number of reasons: gain market share, gain new geography, gain scale, gain a low-cost operation, gain technology, consolidate a distribution chain or channel, or simply add more capacity. In addition to these sound business reasons, strategic buyers that are public companies have been known to make Add-On deals just to hit their published growth targets (this has been called revenue putty) or hit their earnings targets. Big strategic buyers have no problem paying cash for good Add-On deals or, if they are public companies, paying in stock.

Financial Buyers are investment funds that have raised a pool of capital (typically $50 million to $500 million) from insurance companies, pension funds, college endowments, and wealthy families, and use that money to acquire private companies. Their strategy is to grow the companies they buy and sell them at a higher value in three to seven years. One of the key strategies they employ is the ***Platform & Add-On approach***. This means that financial buyers will study an industry and make a ***Platform Acquisition*** of a large company with the objective of accelerating its growth with, yes, Add-On deals. Once they have the platform, they are hungry to do the Add-On acquisitions that will get them to hit their growth targets. Add-On deals are bred into the thinking of financial buyers.

Why are Add-Ons hot today for both strategic and financial buyers? Today's economy is uncertain. This means that buyers are looking for deals that they understand — that are in the industry that they know. Public companies have benefitted from return of the value of their shares which makes it easier for them to make acquisitions. Add-Ons are relatively cheaper now that their stock has recovered somewhat. Their stock price depends on their achieving growth targets and Add-On deals are a certain way to build growth into their financial statements.

Financial buyers are caught between a need to put their capital to work and reluctance to assume any new risks. More than $400 billion (yes, billion) has been raised by financial buyers to make acquisitions. They need to invest over the next 12 to 18 months or they might have to give it back to their investors. Yet, they are reluctant to take risks into new investment areas (no new Platform Deals). Their solution is to invest it into more Add-On deals to grow companies they already own in industries they already know.

All of these factors combine to make Add-On deals a great way for owners to sell their companies in today's economic environment. The deal values can be strong and terms good for the right match with a strategic or financial buyer. The due diligence process to get to closing is faster and easier in an Add-On deal. Finally, sellers can often get a deal done and not have to stick around afterwards.

Corporate Finance Associates
24461 Ridge Route Drive, Suite A200
Laguna Hills, CA 92653

T/ 949.305.6710
E/ info@cfaw.com