

Acquirers' rules of engagement

Long-valid considerations key to growth



Zoran Bozicevic/National Post

File photo. One of Brad Cherniak's rules for acquisitions: stay the dog, not the tail. In other words, don't change your core business because of an acquisition.

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Before the bottom fell out of the economy and markets last fall, there were plenty of good companies trolling for acquisitions. Growth was king, capital was plentiful and everything looked rosy. Now, cash is king, capital is hard to pry out of investors' hands and every opportunity looks tough if not terrifying.

For small to mid-sized businesses this means company valuations and deal terms have swung widely toward the buyers. Many fundamentally strong companies have been cut off at the knees by recent events, softening them up as targets. This is truly a buyer's market. Add the inherent need of SMBs to continuously grow to survive, gain critical mass and thrive, and acquisitions should be in every healthy company's sights today.

However, entrepreneurs and their shareholders should also give serious thought to the flipside: That is to sell to get cash to invest in the markets while they are still reeling and then ride the upside of the recovery with more-liquid investments in larger companies. You should be doing the math and comparing alternatives for your wealth.

If you are in the enviable position to be an acquirer, the current environment makes some long-valid considerations more important than ever:

Stay the dog, not the tail Don't fundamentally change your core business with an acquisition. It's rarely successful and high risk at the best of times. Keep your eyes on the prizes you have. For example, continue to maintain and deepen relationships with the customers who account for a disproportionate amount of your profit. Acquisitions should add geographic coverage, customers you are already courting, or robust technologies that are complementary to your offerings. Bottom line, your company should not look drastically different post-deal than it did pre-deal, only stronger.

Don't become a bottom feeder Offer reasonable prices. Recognize you have the leverage and structure:

- Be conservative, protect yourself in all reasonable respects, whether in warranties, or obligations relating to staff, or legal or other contingencies. Don't take unreasonable risks to win the prize;
- Incent the seller by using such terms as earn-outs, performance-based incentives, staged or contingent payments, claw-backs, ratchets, reverse ratchets and vendor take-back financing;
- Do due diligence; leave no stones unturned. Trust no one, or as Ronald Reagan so aptly noted in his arms treaties negotiations with the Soviets in the 1980s, "trust but verify"; and
- Analyze and know the value of the target and offer a reasonable price against this value. If it's worth \$10-million to you, it is not reasonable to offer \$1-million.

Don't try to be too clever Seek targets with simple fits to your company. These days, always assume everything will be harder to accomplish and more expensive than it first appears. Get back to your routines as quickly as possible. The distractions of closing deals can be fatal to your business if you take your eye off the ball too long or neglect customers.

Know your balance sheet Be certain you can afford the deal and have adequate resources left to run your business. Model your existing cash needs carefully; you should be doing this anyway. And don't assume your banker will be on board; do the math before asking.

Also, figure out what resources you will need to consume or temporarily reassign to integrate the acquisition--people, professional fees, technology, hard assets or physical space.

These considerations were paramount to Louis Cordeiro, owner of Toronto-based Southwest Binding Systems, a manufacturer and global supplier of binding and laminating equipment and supplies, acquiring a major competitor last year. He says it's what kept the company profitable through the integration of the acquisition and subsequent economic collapse, and he is now in the market for smaller tuck-under deals in Western Canada to augment his national customer base.

"If I do this right, I should be able to accelerate Southwest's growth and profitability with a series of disciplined acquisitions while staying focused and thereby increase value steadily through good times and bad."

Sticking to these considerations, just about any company can use these difficult times to accelerate or reinvigorate its business at a reasonable price and risk, while taking out some of the competition.

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