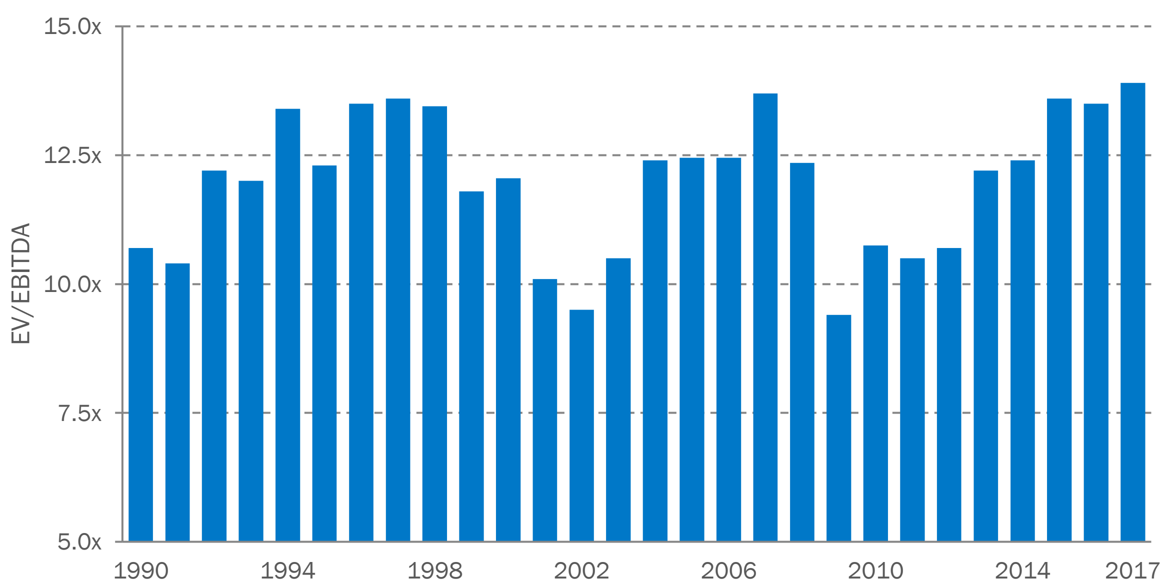
Valitas Insights: Driving Growth in Your Acquisitions

Part 1: Getting A Bang for Your Buck in Today's Pricey M&A Market

This article is Part 1 of a 2-part series about driving growth in new acquisitions against the backdrop of today's challenging M&A landscape. With valuations at record highs, it is more critical than ever for buyers to develop realistic growth plans for their target acquisitions. Part 1 of this series considers the steps buyers can take during the due-diligence stage to establish realistic growth objectives. Part 2 will explore a post-acquisition action plan for buyers aiming to meet their growth objectives.

Historically, 70 to 90% of M&A transactions fail to create value. In addition, potential buyers, both strategic and financial, now find themselves having to pay more for targets than ever before, with valuations in the global M&A market reaching record highs. Combining this propensity for deal failure with sky-high valuations, it is more critical than ever for buyers to realize growth in their acquired companies.

Figure 1: Median EV/EBITDA acquisition multiple for transactions of at least US$25million (x)



With this challenge in mind, Valitas recently sat down with Todd Blair, Founder & Managing Partner of GrowthPoint, a Canadian advisory firm specializing in the planning and execution of growth strategies. "It's essential to identify key growth factors and actualize growth strategies in acquired companies," he told us, "but that while key growth factors are simple on a conceptual level, establishing the processes to address each factor is an intricate undertaking that involves meticulous planning and execution.

"Addressing each of the key growth factors is kind of like going through the 140-step IKEA manual to build your bed."

Setting revenue targets, for example, is a complex task with an extensive list of sub-tasks and considerations. Mapping out and executing each of these sub-tasks is a daunting undertaking for small to mid-sized companies that do not have sufficient resources to dedicate to acquisition integration and strategic planning.

With respect to M&A, Mr. Blair identified three factors that an acquirer should contemplate at the due-diligence stage, to improve the probability of meeting or beating acquisition expectations.

1. Validating the opportunity
   While seemingly simple, this is a pivotal consideration where many acquirers fall short. In Mr. Blair's experience, acquirers often fail to ask key questions about the target company, even when those same questions have been addressed internally:
   - What is our market share today?
   - Where are we going to drive organic growth?
   - Where is our new customer acquisition going to come from?

2. Evaluating the go-to-market strategy
   Developing, evaluating, and refining a go-to-market strategy for the hypothetical merged company is a crucial step in assessing realistic growth opportunities. A prospective buyer should contemplate the following questions before formulating a plan to execute on each:
   - Which markets do we pursue?
   - Which customers do we target?
   - Which channels fit with how our customers buy?
   - How do our offerings fit with our markets and channels?
   - What is our unique value proposition to each customer?

3. Setting revenue targets
   Most companies set revenue targets, but these targets are not always grounded in reality; using historical data to project future performance does not suffice. In order to achieve performance that is consistent with acquisition expectations, revenue targets should be supported by a strategic plan consisting of actionable items and measurable milestones. This requires a thorough understanding of the target company's operations, and how they will be integrated with the buyer's operations.
   A recent McKinsey study also emphasizes the importance of setting realistic targets. As part of this study, McKinsey polled over 1,000 C-level and senior executives, and identified five best practices to consider in achieving revenue-synergy goals, with the most important factor being to "validate the deal model to set realistic targets." Of those executives that reported meeting or exceeding revenue-synergy goals, 87% validated the deal model to set realistic targets, compared to only 46% of those that did not meet revenue-synergy goals.

Figure 2: Percentage of respondents who say their company did the following in acquisition integration

One of the biggest mistakes acquiring companies make, according to McKinsey, is that they move too quickly to capture revenue synergies without confirming that pre-deal assumptions will not threaten the base business. Survey respondents who reported preserving and protecting existing revenue were significantly more like to meet or exceed synergy targets. This finding speaks to the level of intricacy required in planning and executing growth strategies, as alluded to by Mr. Blair, and highlights the importance of having a dedicated and knowledgeable team that understands what questions to ask.

As we reached the end of our discussion on due diligence factors, Mr. Blair noted that, in his experience, companies that are more effective at driving their own organic growth tend to have greater success integrating their acquisitions, as they have the correct processes and disciplines in place. Developing and implementing these processes requires both capacity and experience. Whether that capacity and experience is sourced in-house or out, including these capabilities in a deal team is essential to driving growth after an acquisition.

Todd Blair and the leadership team at GrowthPoint Advisory Services leverage their hands-on experience and intellectual property to identify growth opportunities and actualize growth plans in small to mid-sized corporations. You can reach Todd @ todd@growthpoint.io or 416-855-2646 ext 102.