Valitas Insights: Avoiding Post-Acquisition Surprises

During a recent conversation with a senior M&A lawyer, I mentioned that I was writing an article about avoiding post-acquisition surprises. "Send me a copy," was his response. "We're all trying to avoid those."

When buyers consider an acquisition target, the focus is typically on strategic fit and valuation. The subsequent due diligence process is used as a security blanket to validate the buyer's vision of the target. However, the typical due diligence checklist doesn't address the subjective areas of the business – those involving people, culture and processes – that are often the source of post-acquisition surprises.

The very nature of a surprise, of course, is that it is unexpected, which leads to the following question. How does one anticipate the unexpected while engaged in the acquisition process?

"Predictions are difficult, especially about the future"

-Niels Bohr, Physicist and Nobel Prize Winner

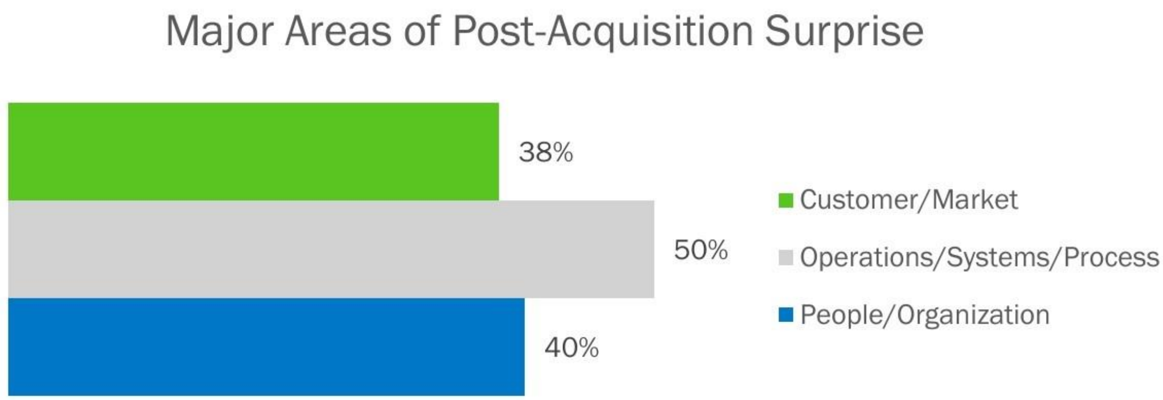
This question is considered in a recent National Center for The Middle Market article. The authors surveyed executives, investors, and advisors, and distilled several useful insights and recommendations from their experiences.

Survey participants reported that post-acquisition surprises impacting value expectations were more typically found outside typical due diligence areas, with the highest surprise risks coming from:

1. People/Organization;

2. Customer/Market; and

3. Integration focused operations.



While there is no hard and fast rule around creating certainty in these softer areas (a subjective due diligence checklist misses the point), there are several steps that a prospective buyer can take to mitigate the risk of surprise.

1. Be clear about "what you have to believe" for financial projections to materialize. Run sensitivity analyses using different scenarios. For example, where the buyer is restricted from talking to the target's customers, there may be issues that are only apparent post-closing that impact financial projections for Year 1.

2. Use scenario analysis to try and anticipate surprises. Examples include considering the impact of a clash in corporate culture, or unplanned departures of key executives or employees. How would these factors impact the combined operations?

3. Start the integration planning early, and include key acquirer employees in the process so different perspectives are heard.

4. Don't get emotionally attached to the target; try to maintain objectivity and rigour throughout the due diligence process.

With less experience in M&A and fewer resources to manage the process, mid-market acquirers are more likely to encounter post-acquisition surprises than their larger counterparts. A trusted external advisor can be an invaluable resource, raising issues and considering scenarios from a different, outsider perspective. As a wise man once said: "I like friends who have independent minds because they tend to make you see problems from all angles."[1] And this is a critical step towards avoiding post-acquisition surprises.

[1] Nelson Mandela