WHY A MERGER?

In general, we all like to talk about growth, but achieving it organically can be very difficult. No growth means inertia, or worse, yet there are good and bad ways to grow. In nature and biological systems, unhealthy and unchecked growth has a word, and even in business, some ways of growing are far better and healthier than others. And by that we mean such ways are healthy for customers, employees, and shareholders alike… and sustainable for the longevity of the business.

As a firm founded by and focused exclusively on Founders and Founder-owned businesses, Acresis deals in growth options on a regular basis: our mantra and mission is "growth, liquidity and wealth" all geared towards Founders. To date we have helped source and develop capital, talent and better ways of working for over 30 Founder-owned business, including several successful mergers, with a resulting $1B in incremental and realized value over the last 5 years.

Every Founder's path to value is different. But at some point, when growth is on the table, and the levers of organic growth are insufficient or in need of complement, the question of a merger or acquisition arises. While the two words often go together - "M&A" – they are two separate and unique paths. So let's ignore "acquisition" as a path to growth in this article and focus on "merger". When it comes to merging two companies, there are several inter-related opportunities and challenges to consider:

WHY SAY "YES" TO A MERGER?

- Scale: Consider two companies, each under $10 M in revenue. From a merger perspective, they are both sub-scale for an exit, which can also make valuation difficult.Typically , we deal with companies in the $5 M to $50 M range in revenues, yet find that exceeding the $10M in revenue automatically gives companies a higher valuation multiple. For the typical tech-enabled services business this might be the difference of 4-6X EBIDTA versus a > 6.0X valuation if you can get over $10 M in revenue.

- Costs: For merging companies there is the advantage of combined overhead and the cost savings generated from "synergized" systems and processes. Typically back-office functions are easier to identify and understand for companies than are mid-office and front-office processes. Imagine two $5M companies merging, and eliminating duplicative finance, accounting, HR, IT, real estate, insurance, and other admin functions. For companies of the above size, this can save > $1M in costs per year and every dollar you save drops to the bottom line, which is where you get a > 6.0X EBITDA multiple.

- Sales: This is perhaps the most crucial reason why Acresis favors and fosters mergers among our clients. After all, sales are what real growth is all about. In those cases where services, products and customers overlap there can be enormous opportunity for cross-sell and up-sell. Sub-scale companies often bemoan the lack of sales resources, the high cost of quality salespeople and a lack of sales coverage in their target markets. A merger can create a better resourced, more professional sales function that will measurably lift the top line.

- Risk & Capital: While more employees, markets and channels may entail more risk (or at least require greater vigilance), more scale also provides more resources (people, capital) with which to manage downturns. A newly merged entity also means more EBITDA and more capacity to raise capital through debt or equity. Survival is no longer on the shoulders of a single Founder or single founding team . . . but on the combined Founders/management team.

WHY SAY “NO” TO A MERGER?

In some sense, every merger’s promise will depend on the evaluation of how the deal will impact the above factors, which in turn will drive the decision of whether to merge. However, there are also some common pitfalls and events that can scuttle an otherwise well-conceived merger, which are just as important as the reasons a company might seek a merger in the first place.

In our experience, we find that mergers usually are made or broken by the following factors:

- Control: Who is in charge? Sometimes merged organizations have multiple leaders who may not know how to share power together, which reduces the likelihood that their chemistry and relationship will add commercial value. Instead of 1 + 1 = 3, you risk a negative effect when leadership and control are unclear, ambiguously shared, or co-owned by two people without a history of success together. Supporting this concept of control is the very important task of ensuring that the role of every leader and manager (every employee really) is also clear.

- Talent: As the old adage goes, no one really ever likes change, at least at first. This can certainly include your best performers who have earned their way to a certain level of prestige and compensation and who now face being a smaller fish in a bigger pond. Ironically, the “selling point” to them should be “more to sell” or “more to manage,” but it’s important to make sure that your rock stars come out the other end of a merger with their opportunities and prestige intact. This sets them and the company up to go do great things for NEWCO.

- Compensation for Now & Later: Does the cash compensation of the merged founders and executive team go up or down right away? Ideally, people are more valued and thus higher compensated when they are put in place to drive a bigger, faster ship. We’ve also found that stock (and certainly stock options) have much less allure than they once did and that nothing speaks to executives as unequivocally as cash. At the same time, when key people know there is a liquidity event in their future, when that is a stated part of the merger’s ultimate goal, this can be extremely motivating for obvious reasons.

- Attribution: On an emotional level people need to be recognized for their hard work and accomplishments. As aggregations of people, companies are no different. So, when two entities merge it is important that there be general agreement on what everyone’s past, present and future contributions will be worth. Is $1 dollar of Company A’s revenue or EBITDA the same as that of Company B? Does one company have recurring, and thus more valuable revenue? Is the source of higher margin attributable to one or the other? Such deliberations and decisions help determine ownership positions on Day 1.

In summary, we believe Founders should contemplate mergers between sub-scale companies more frequently. When done well, enterprise valuation increases; valuation multiples increase; risk decreases; and a more reasonable path to value and liquidity can be achieved.

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