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Growth and Value Creation Through M&A Roll-Ups

2021 was an all-time record for mergers and acquisitions, with easy access to money and skyrocketing stock markets. Based upon multiple deal forecasts, 2022 is set to be just as busy. One of the reasons for this heightened activity is companies using M&A to grow their market presence and create more value. Increasingly used is a roll-up or serial acquisition strategy. Common among private equity and strategic buyers, this strategy is a way to increase value through acquiring multiple smaller companies in the same industry and consolidating them into a larger platform.

A roll-up strategy allows buyers to quickly scale within their industry instead of waiting for organic growth. The goal of the larger platform company is to decrease shared overhead, deploy resources to a greater market area, and quickly grow topline revenue. The end result should be that the consolidated company is worth more and performs better than each of the individual companies could have on their own. As further explained below, many factors play a 'role' in a successful roll-up strategy, but don't be fooled, there are some pitfalls to avoid. A local CFO provides insight as to implementing their best practices.

What Industries are Best for Roll-Ups?
The best industries for a roll-up strategy are those that are:

1. Highly fragmented with no market leader, such as emerging sub-industries in technology and software, so they can quickly realize the benefits of being a larger organization.

2. Common and necessary across regions so that there will be many target businesses available at lower purchase price values. This is especially true in a hot M&A market where individual multiples are at record highs. Often these industries have a lower barrier to entry but need the buying power and sophistication of a larger organization.

3. Simply organized so they are easier to integrate into the larger platform with shared and automated overhead.

4. Forecasting positive economic growth so investors can realize the benefits of size in a growing industry.

What are the Benefits of Using a Roll-Up Strategy?
Roll-up strategies create additional value to the platform company by:

1. Economies of Scale: By pooling buying power and consolidating back-office functions, the larger company can typically operate on reduced costs while still servicing the same revenue stream. Note, this benefit can only be realized if the platform actually takes steps to streamline and consolidate their functions – otherwise it is more work to manage differing systems under one roof.

2. Speed: A company can grow faster by buying product lines or market share than it can by organic growth. In a growing industry, being the leader can guarantee success.

3. Cross Selling to Existing Customers: Provide the collective group of customers access to goods and services of the rest of the larger company. Sometimes the same inputs can generate higher value to other customers on the same platform than their previous distribution.

4. Increase in Knowledge: If you value the prior owners, the wisdom and knowledge of the collective group should be better than each individually. Platforms can use these resources to improve the operations and future planning of the entire enterprise.

5. Value Multiple: All things being equal, the larger enterprise can often sell for a higher multiple than each individual company's value in the roll-up process. This arbitrage can allow for multiple exits for sellers as the business grows.

What are the Pitfalls of Using a Roll-Up Strategy?
As great as these acquisition strategies can be, roll-up strategies are prone to failure.

• Acquisitions should not be a goal in and of themselves – the company needs to use the acquisition in order to achieve a greater organizational purpose. An acquisition that does not help the buyer achieve that greater purpose will be an unnecessary burden on the team and potentially drain cash flow and morale.

• The acquired company needs to actually be integrated into the platform in order for everyone to realize economies of scale and the benefits of more customers. Just as much planning and attention needs to be done post-closing as there is focused on due diligence.

• Platform acquisitions tend to be on a tight timeframe. But with speed, there is a risk in missing problems that should be uncovered in the diligence process.

What are Some of the Best Practices for Implementing a Roll-Up Strategy?
1. Goals: Set achievable goals well in advance of implementing your roll-up strategy. Oliver Phillips, CFO of electrification services provider Qmerit in Irvine, stresses the importance of developing an overall strategy, but to be prepared to pivot the plan. Think through annual goals as well as the eventual exit strategy. Both investors and rollover sellers want to understand the timeline and plans for the future direction and be part of creating long-term value.

2. Culture and Values: Decide what kind of company you want to build and the culture and values you want to develop. Identify target companies that fit into or complement your culture and values. Be prepared to adjust with growth, but make core value changes purposefully and not accidentally.

3. Team: Have a strong management and finance team, development and integration team, and legal counsel sophisticated in M&A processes and with industry knowledge. Sellers care about more than purchase price – they want to know who will take over and manage their baby.

4. Process: Automate or streamline the acquisition process. Having each step of the process planned out with budgeted expenses increases the likelihood of success and keeping the acquisition within your goals. Deviating too much from the process slows down diligence and negotiation, leads to confusion and mistrust, and can result in a failure to close the transaction.

5. Cash Flow: Mr. Phillips reminds CFOs to "keep your eye on cash flow, especially when you see attractive acquisitions. It is easy to be caught up in the excitement of closing deals and overpay or buy the wrong target." CFOs need to manage the economics of the whole platform (KPIs) and the implementation of each part of the acquisition strategy.

6. Integration: Plan integration early on and identify problems prior to signing your deal. Ideally, you are starting with a solid platform company that you can integrate into; but sometimes you have to piecemeal to create the platform. In either scenario, the consolidated company should be a vast improvement for each individual company. Know how you will improve each target company to drive profitability and competitive advantage after the closing.

7. Employee Engagement: Include each target company's key employees and management as part of the team. Re-evaluate roles and responsibilities to best use people's skill sets to grow the consolidated entity. "Don't be afraid to hire flexible and energetic people who will be creative and adaptive in implementing the consolidation strategy" says Mr. Phillips. Show employees career opportunities, instead of focusing on potential lost positions.

8. Pulling the Plug: Don't continue to throw good money after bad. If you realize during the negotiations that the target isn't right, stop the pursuit. Better to have invested the money to discover that the target wasn't right than to close and drag down the value of the entire platform. Sometimes the best deals are the ones you don't do.

Acquisitions for growth and value creation will continue to be strong in 2022. But the current high valuations, inflation, and market volatility could impact the availability of good transactions. Don't let the fear of missing out force you to make poor acquisition decisions. Execute your acquisition strategy with purpose and your team will be excited and motivated to see it succeed.

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Christina McSparron works closely with entrepreneurs and corporate clients across the country at all stages in the lifecycle of their businesses. She has extensive experience on both sides of the deal, representing buyers and sellers in mergers and acquisitions and other business combinations (including leading roll-up acquisitions for acquisitive clients). Often serving as general outside counsel, she advises on entity structuring, corporate governance, growth and exit plans, contract negotiation, debt and equity financing, licensing, and general business operations. Ms. McSparron's clients are in diverse industries, including automotive, technology, restaurant, food and beverage, building materials and manufacturing, service and retail.