Acquisitions
and the Mid-Market
CEO

Survey of Alliance CEOs shows it's now on their front burner – *but it's easy to get burned*

By Robert Sher

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Acquisitions and the Mid-Market CEO

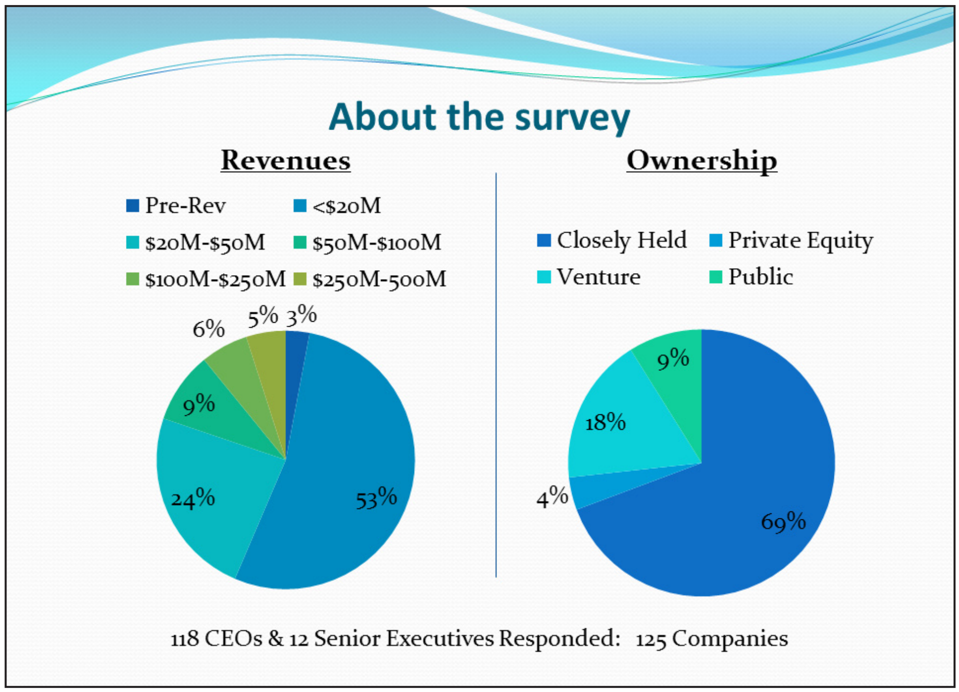
Acquisitions take root well when placed in companies that are prepared

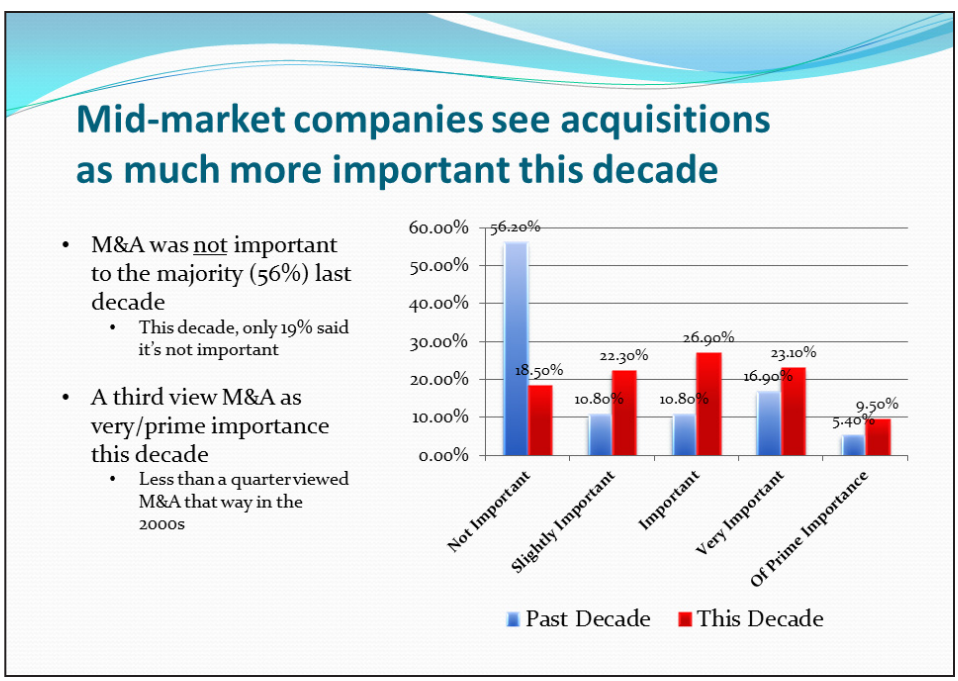
*This survey was sent to over 300 Alliance of Chief Executives members in the greater Bay Area between January 13th and January 22nd, 2012. It is part of a larger research effort being conducted by **Robert Sher**, principal of CEO to CEO, in cooperation with the Alliance of Chief Executives. The focus of the research is to better understand how mid-market companies can improve the likelihood and magnitude of acquisition success. In addition to the survey, in-depth interviews are being conducted with leaders of mid-market companies who have acquisition experience. More information on this ongoing research project can be found on the back page of this report.*

Growing through acquisition is an enticing prospect for many mid-market companies. Indeed, about 5,300 transactions among businesses valued between $5M to $1B took place in 2010, according to Dealogic and Robert W. Baird & Co., with the vast majority involving deals valued at less than $100 million. Sadly, though, many of these deals fail to fulfill expectations. In fact, most evidence suggests that mergers can boast a mere 50 percent success rate – and even that figure may be generous.

Among members of the Alliance of Chief Executives, an active community of Northern California chief executives that focuses on deep strategic exchanges, CEOs who run mid-market companies seem to fare slightly better when measured by M&A success. A recent survey of Alliance of Chief Executives members found that nearly 60 percent reported completing deals which achieved their non-financial objectives. Still, those are not great odds, considering that 40 percent of respondents did not. The matter becomes even more serious when you consider the increasing importance of M&A activity as a path to growth. In the same survey, more than half of Alliance of Chief Executives CEOs rated acquisitions as "important," "very important" or of "prime importance" to their company's success over this decade. With so much at stake, it is critical that we do deals right – and the truth is we can.

Mark Iwanowski, an Alliance of Chief Executives alumni and now



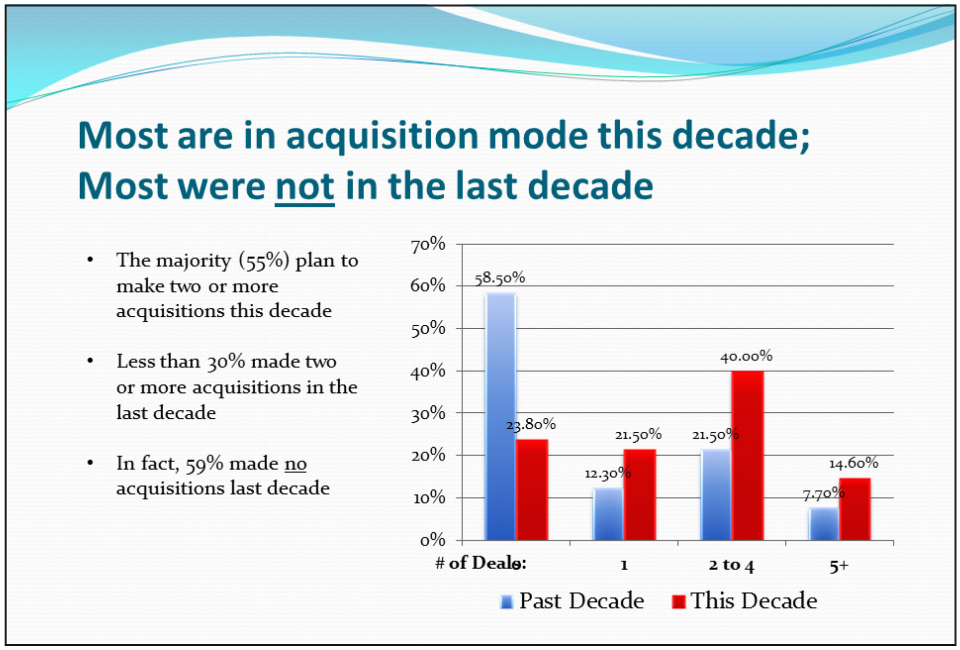


Managing Director at Trident Capital, a private equity and venture firm, has been on both sides of the M&A scenario. Iwanowski once worked as COO for a consulting services firm which stood at the top end of the middle market. Acquisitions accounted for 25 percent of the company's growth rate, as the firm acquired businesses and integrated them or operated them as stand-alone business units.

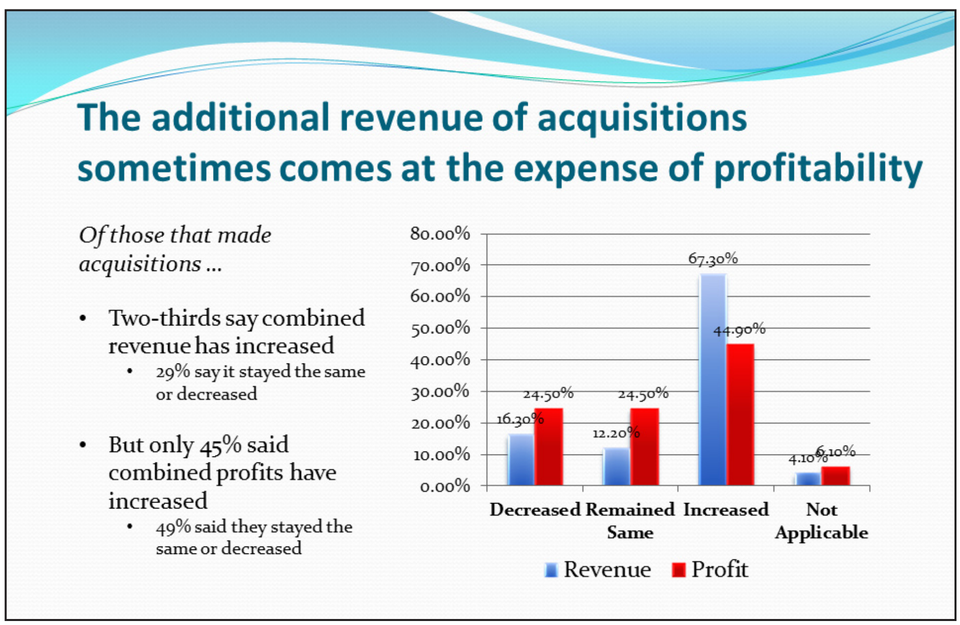
Mark Iwanowski
Trident Capital

When approaching these deals, Iwanowski said, his company's goal was to set expectations with the seller's management team early – no surprises. "In the case of a stand-alone business unit bringing new technology, new offerings and new capabilities, the context of the discussion was around working within the corporate culture," Iwanowski said. "The one thing we did ahead of time is cross-check the cultures, set expectations, so that everyone's eyes were wide open going in."

Once they truly understood what it would be like to work in his firm's culture and to execute the new business plan, 20% to 30% of target firms actually walked away from the deal. But Iwanowski's company was happy about that, since the talent would have walked away after the deal closed anyway. More importantly, perhaps, is that his company had an acquisition failure rate of between 10 and 20 percent. We should all be so fortunate. But the truth is that doing deals right involves allocating enough real resources to make them work.

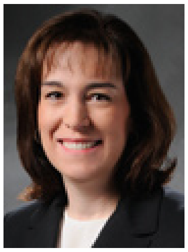


At the presentation, there was discussion as to why company leaders are planning so much more M&A activity this decade. Among the comments were: More opportunities to buy due to struggling companies not recovering, an aging population of business owners looking to retire, stronger balance sheets and cash balances for PE groups and companies looking to invest that liquidity, and strong companies finding it difficult to grow organically and turning to acquisitions for top line expansion.



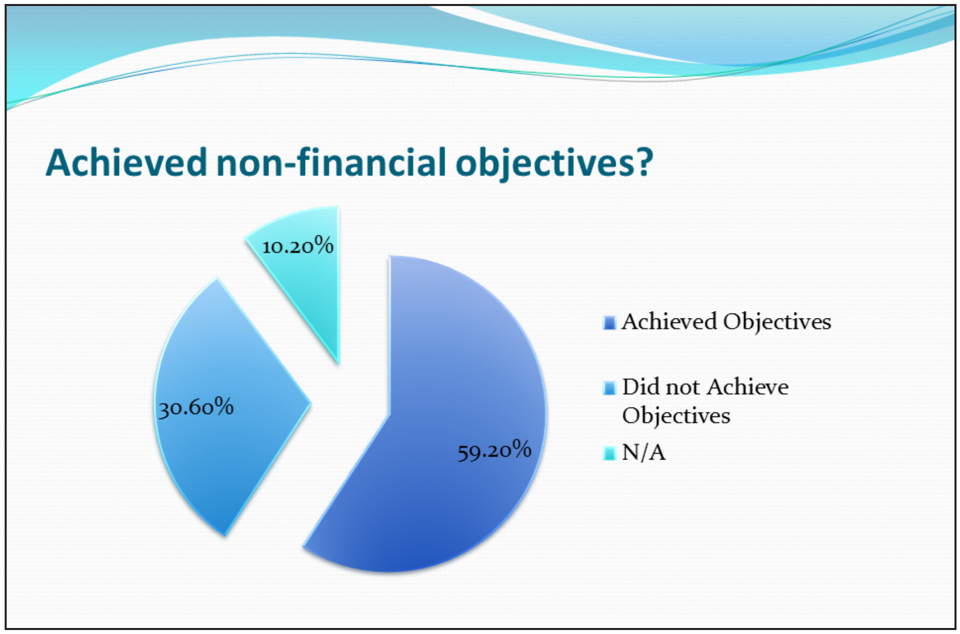
Acquisitions are less often accretive to the bottom line than to the top line. This speaks to the heart of our research study: How to make acquisitions more successful.

Alliance of Chief Executives Member Laura Stark's firm, Rambus (NASDAQ: RMBS, Rev $320M), one of the world's premier technology licensing companies, has done several business acquisitions (in addition to over a dozen asset acquisitions) over the past three years. Rambus examined acquisitions in two phases – tactical onboarding and integration followed by strategic integration. Altogether, the process takes a very involved and intense 90 days. However, Rambus has a corporate development team of five people who report to Laura (SVP Corporate Development), who only do corporate development work, nothing else. She also has two dedicated M&A team members – one in the corporate legal organization, and one in the company's licensing division. Plus Rambus has a project management office (PMO) that is currently hiring a manager to focus specifically on managing integrations. "Basically, it will help us develop our playbook a little bit better for integrations," says Stark. "This person will be involved with helping on the diligence side, but then will be a resource specifically on the integration side to help pull together best practices for us."

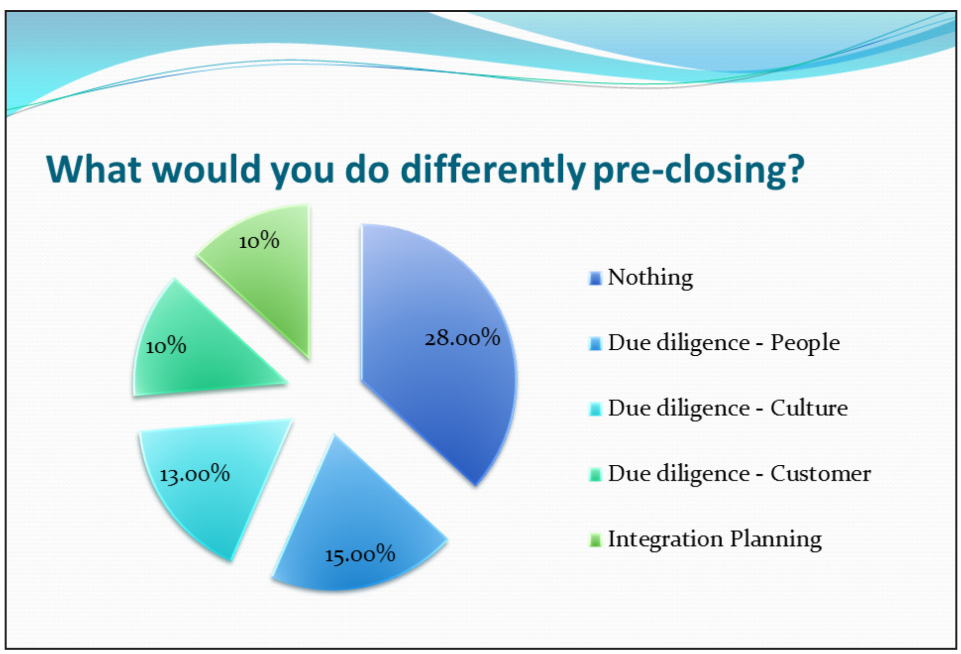


Laura Stark
Rambus

This is a lesson to us all that regardless of our scale, we must be generous with our resources if we want a higher success rate. While it is true that many mid-market firms do not have a corporate development team or even staff whose primary focus is M&A activity, there are still ways to increase the



Most midmarket surveys show a success rate at about 50%, yet this survey shows a higher success rate of the low 60th percentile (see this slide and last slide), depending on how the data is interpreted. Why? It may be that the survey pool (Alliance members) are not a random selection. Chief executives that choose to join the Alliance tend to be learners, striving to step up their game. It also may be that most mid-market surveys are of larger companies with a much higher percentage being public, whereas our sample has a predominance of lower middle market companies whose leaders are very close to the week to week activity of their companies, including acquisitions.



About half our respondents felt they needed to do still more due diligence, but not on finance, legal or technology. Assessing people, culture and customers are much harder to outsource, and require management time and bandwidth.

likelihood of acquisition success by making conditions just right. In other words, they must "prepare the soil for the planting of the acquisition." Here's how:

1. Aggressively gather market intelligence. We must step up our competitive intelligence, marketplace awareness, and scouting for candidates to acquire. This will help us make better, faster decisions – and it will give us options, so we will be better able to walk away from bad deals.

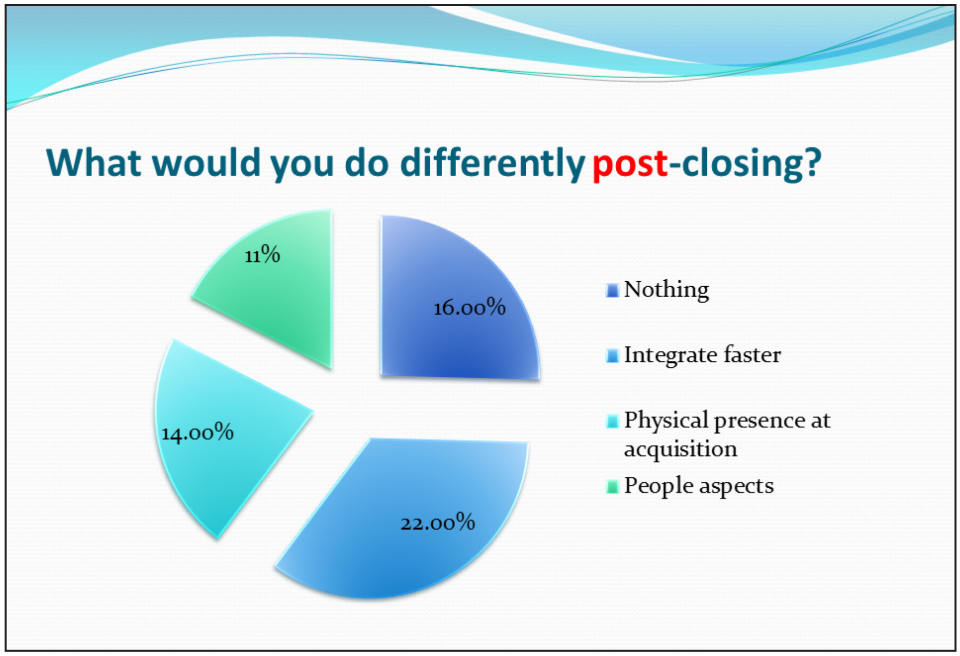
2. Build management ranks. Build up your management bandwidth, so that when crunch time comes, you're able to focus on the acquisition – due diligence and integration – with less neglect of your core business.

3. Employ project management resources. Someone with project management expertise and know-how can be used across the organization, but can also be called upon to focus on M&A integration.

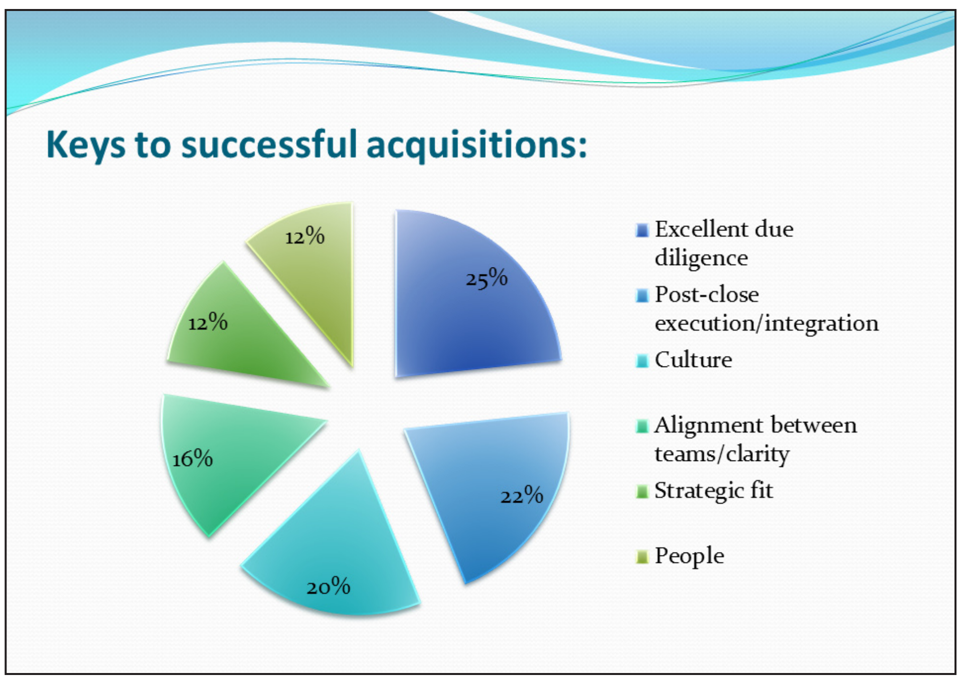
4. Grow cash reserves. Companies need money beyond the financing of the deal to outsource due diligence and other services as needed. They must both pay for the acquisition and adequately fund the integration – which has costs of its own.

5. Stay aligned and committed. For any company seeking to grow through acquisitions, all M&A activity must align with and serve the company's overall strategy. Both buyer and seller management teams must be committed to the same goals. The overall strategy itself has to be clear. All deals that do not meet these basic requirements must be avoided.

Companies that put in the work



The percentage of respondents that were satisfied with their post-closing performance is lower than their pre-closing performance. Integrating faster and more effectively is at the top of the list.



and investment to prepare the acquisition soil will find the harvest exciting. Just ask Alliance of Chief Executives Director Ken Ansin. Ansin bought a $15M portable toilet firm, Handy House, and within his start-up United Site Services, grew it to a $120M business through a series of approximately 30 acquisitions. He “thickened” middle management to help integrate the smaller, mom-and-pop type businesses it began buying in one local area after another. Once United Site Services had enough business in one metro area, it used the same management bandwidth to move onto a new area. “It was much easier to sprinkle middle management into the contiguous market as we grew,” Ansin says.

Ken Ansin
Alliance Director

United Site Services had properly conditioned its “soil” and suitably prepared for acquisition growth. When companies do this, they have the capacity to do the following:

Perform thorough due diligence and deal sourcing. Having extra bandwidth to do proper due diligence means your managers won’t be pulled away from regular tasks and core operations will not be neglected. Keep in mind, however, that you can outsource legal and accounting due diligence, but you can’t really outsource operations, culture and people due diligence. These critical tasks must be done by your team.

Marty Reed
The Roda Group

What we're hearing: three strategies make or break an acquisition

1. Do thorough due diligence and deal sourcing.
2. Plan the integration early and in detail.
3. Integrate quickly, aggressively and comprehensively.

Plan the integration. Integration planning runs concurrently with due diligence before the deal closes, so it will be an extra drain on resources. It also continues for 30 to 90 days after the deal closes. It is at this stage that project management expertise is critical, since complex action must be coordinated throughout both buyer and seller teams

Execute the integration. Although it is a gargantuan task in most cases, many CEOs who look back at past integrations wish that they had pushed the pace more aggressively. Don’t be afraid of going faster! Putting in extra time and resources can help your organization get past attending only to the urgent work, to doing the important work like building relationships between people. Allocation of sufficient resources also makes it easier to measure progress and adjust course, if necessary.

To insure that a new acquisition takes root quickly, consider keeping post-close some of the outside resources that helped with due diligence. Says Iwanowski: “What tends to happen is you bring those teams in, they do the due diligence, they help get things done, and then it’s basically thrown over the fence to the organic operational team to figure out now how to move the process through to completion.”

Some more food for thought when it comes to finding “seeds” for planting deals: Kiss a lot of frogs. Alliance of Chief Executives Member & Director Marty Reed, who serves as a Principal of The Roda Group, a venture capital and private equity firm, encourages companies to “be incredibly open” to acquisition opportunities. Reed recalls one acquisition opportunity during his time as Director of Finance with Ask Jeeves, a fast-growing search engine, that did not look interesting on the surface, but by opening up the conversation, “it got a little interesting, then it got a little more interesting, and we did the deal. Two years later it was, in some ways, the smartest deal we could have possibly done.” The deal would not have happened if Reed had not left open the door to the possibility.

While bandwidth is often the toughest challenge for mid-market firms, having enough of it is absolutely critical to getting deals done, because a lack of bandwidth usually leads to a lack of due diligence. Consider the fact that more than half of all Alliance of Chief Executives members surveyed with experience in acquisitions, when asked if they would do anything differently to prepare for their last acquisition, said they would have done more due diligence around the people, culture, customers and integration planning. And Alliance of Chief Executives members named "excellent due diligence" the number one factor in making a successful acquisition – followed by post-close execution/integration.

Here's one example of how due diligence can save time and effort. Sabine Castagnet is COO of Data Physics Corporation, a provider of high performance solutions in signal processing to the noise and vibration community. Her company acquired a French firm in 2000, but it took an incredible ten years to fully unite the teams. Why? "There were two founding owners in France, and the teams didn't fully bond until after they retired," she says. "I guess 'rivalry' is the right word. Between the U.S. team and the French engineering team, they could never say 'we' -- it was always a 'they' and 'us' type of orientation. It didn't stop us from having good products and getting sales and profits, but it was painful internally, unfortunately."

The truth is that doing deals right requires the CEO to ensure that these five uncommon elements are in place: market intelligence to deeply understand the target company, management bandwidth, project managers to orchestrate the integration, a cash reserve beyond just the financing to buy the company, and management teams on both sides who are committed to the same goals. There are no shortcuts, and no second chances once the trigger is pulled. When it comes to M&A, better bandwidth equals better results.

Robert Sher *is founding principal of CEO to CEO, a consulting firm that improves the skills of chief executives of mid-market companies who are navigating major shifts in their business or marketplace. In 1996, Rob was one of the initial members of the Alliance of Chief Executives, and continued as a member for 11 years until he founded CEO to CEO. For the past five years, Rob has been a member of the Alliance Team of Directors. The author of two books ("The Feel of the Deal" and "Defeating Corporate Distractions"), Robert was CEO of a publishing company for more than 20 years before launching CEO to CEO in 2007.*

Research Project: Call for Candidates

Learning From Mergers That Actually Worked:
The Lessons of Successful Mid-Market Company Acquisitions

We don't believe that mid-market M&A is just a nasty numbers game. We believe that there some approaches that can make a good, or even great outcome more likely, and we're doing our homework to get clearer on exactly what moves constitute best practices for the mid-market and to find M&A stories. If your firm, or a firm you know with revenues between $20M and $1B has had an acquisition and integration in the past five years, we'd like to talk.

Mid-market companies are especially vulnerable. Whereas a large firm can write off most of their bad acquisitions from the profits from their much larger, core business, most mid-market firms are risking the whole enterprise. They make acquisitions using their line executives, distracting them from core operations. They often have no corporate development function, and those that do have it thinly staffed. Mid-market M&A seems to be gaining headway, but most firms aren't in a position to take big risks. Getting it right is critical.

The Research Effort

CEO to CEO, a management consulting firm and mid-market thought leader is focusing a research effort on this critical mid-market problem during the first quarter of 2012. Robert Sher, Founding Principal, will direct the research, building on his own experience acquiring and integrating four companies himself. Willing firms will be interviewed either by Robert or one of his researchers.

The Benefits of Participating

The research will address best practices related to selecting acquisition targets pre-disposed to successful integration, pre-close practices that promote strong integration, and integration execution issues, both immediately following close, as well as in the one to two years following.

Companies that participate in the research effort will be entitled to a private post-research briefing with Robert to share the details of the research and key findings. With written permission, success stories may be a part of published articles.

CEO to CEO

Companies that qualify and are interested in participating should contact CEO to CEO.
E-mail Robert@CEOtoCEO.biz, or call Robert at 925-788-1141.