



| INVESTMENT BANKING |

Proactive Acquisitions

The emergence of unprecedented opportunities



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Jeffrey Knakal is an experienced investment banker having built successful practices for JP Morgan, Credit Suisse and Daiwa Securities in New York and achieving a number of “first-time” time transactions for Fortune 500 companies. In 1994, Jeff founded GROWTH PARTNERS to provide a next-generation offering to C-Suite executives of middle-market companies based on the integration of strategic engineering and investment banking. The firm possesses a turnkey set of M&A, capital formation and corporate development capabilities. It specializes in “Value Creation” activities, which pertain to defining and executing a company’s next-level development to create new value (Jeff founded two \$100 million companies based on horizontal integration theses and acquisitions), and “Value Realization” activities, which pertain to preparing for, and executing a liquidity event in a manner to maximize value. Jeff has degrees from the Wharton School and NYU.

Part of my quest is to convey the tremendous opportunity possessed by most companies to “build” proactively, and within this low organic growth environment, grow rapidly and well by acquisition.

The “Carrot”

A dashboard of metrics consisting of modest GDP growth, decreasing productivity indices, tremendous liquidity, the low cost of capital, and a low VIX index are affirmative for acquisition activity.

Further, a Deloitte survey suggested CEOs are oriented toward building proactively (60% anticipate increased build activity), and a Cogent survey suggested acquisitions are now the best way to increase revenue (80% of companies are acquisition oriented). So, a positive setting exists, but this is not the carrot.

Given our aging population, the number of companies owned by baby-boomers is at an all-time high (almost 40% of private companies are owned by individuals 55 years of age and older). This means that an unprecedented volume of business sales are coming, which in turn, will equate to an unprecedented buyer’s market.

The key consequences for buyers include the ability to cherry-pick targets and execute at reasonable prices. The key consequences for sellers include likely reduced valuations and the consolidation of many verticals. As such, future sellers might want to consider first becoming builders.

In summary, today the setting is positive, and tomorrow acquisitions will be entering a new era. First-to-market buyers will benefit the most, and sellers will need to think.

The “Stick”

For those companies that believe “all is fine” or a “need does not exist” regarding building, note this:

Based on two seminal studies – the Olsen study in 2008 entailing 500 companies over 50 years, and the Nunes study in 2011, entailing 800 companies over 10 years – it was concluded those companies that do not regularly build by modifying their offerings become “disrupted.”

Disruption is a key word in the lexicon of Bain and McKinsey, and it is a precipitous fall in revenue typically after the best year of performance, so a pre-disruption condition does not manifest financially and recovery is difficult. Thus, the preventive counter-measure is to modify continuously, and acquisitions are considered the optimal prescription.

The Parameters

There are four types of build options or acquisitions, although only three should be considered.

1. Building the “core.” This involves expanding the same offering to the same customer group, for example, acquiring market share.
2. Building an “adjacency.” This involves a new offering to the same customer group (e.g., expanding the offering).

3. Pursuing “related diversification.”

This involves a new offering to a related customer group, (e.g., adding a synergistic business).

4. Pursuing “unrelated diversification.”

This involves a new offering to an unrelated customer group, for example, adding a non-synergistic business. (This option is considered the least desirable.)

The most robust alternative is the adjacency, as this option is all about bundling as much value as possible. The generally accepted best build practice is to implement the “Duality of Growth.” This concept requires building the core and an adjacency simultaneously.

When it comes to organic versus acquisition growth, the two key elements are the time to market for the former and the target availability of the latter. Horizontal integration (the adjacency option) is the most prevalent build architecture because it possesses the most attractive risk / reward profile. Vertical integration should only be pursued if control becomes an integral consideration.

The most compelling build propositions entail the achievement of revenue synergy, while the business cases entailing cost synergy do produce value, but not in the same profound manner.

In sum, implement the Duality of Growth while carefully diagnosing the best adjacency, and remember revenue synergy is king.

The “Black Box”

The key to a successful build or acquisition alternative is its original design. The weakness of most acquisitions has been poor integration. However, based on the availability of integration “swat teams,” this element should no longer be as problematic.

Design, or defining the nature of the optimal build objective, has been an art form. However, based on the advent of a proprietary best practice, I will argue it is now much more of a science. The new science will produce the optimal proposition fitting a company’s risk, capacity, and resource profile.

The Implementation

All companies should employ a regular process related to defining the optimal build alternative. Some “people” best practices include creating a diverse group to develop and assess alternatives, establishing a competing group, and disincentivizing orthodoxy. Some information best practices include obtaining information from the edge of the company and its marketplace (“Edge-Centricity”),

significantly segmenting data, and testing ideas with customers.

While all companies possess a “strategic opportunity cost,” (which is the greatest source of benign neglect), most companies will find an abundance of opportunity. The challenge is always differentiating among choices, recognizing that the capital market will always support value creating ideas.

The marketplace is affirmative, and an unprecedented buyer’s market is coming. So, for those companies ready to act, the benefits will be substantial. When acquisitions are executed in the proper manner, there is not a more impactful event for a company and its ownership.

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