Stay Tuned
The M&A Sector of the
Building Services Industry:

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STAY TUNED – *A Periodic Update Of The Building Services Industry's M&A Sector*

WHY ACQUISTIONS SUCCEED; WHY THEY FAIL. PLUS, M&A OUTLOOK FOR 2014.

Comment: Thankfully, most acquisitions within the Building Services Industry succeed; however, a few do not. Let's discuss why some acquisitions work and some do not.

Seller Commitment – A must for a successful transaction.

Is it the right time to sell? Difficult to know when, but as time marches on, one may ask that question of oneself more frequently. To be sure, there are many considerations, some of which are more difficult than others. It is a very personal decision, sometimes affecting the lives of others, including family and key employees for which there are strong feelings of loyalty and obligation. It is sometimes difficult to untangle these feelings, however the decision to go forward does not have to be made until all of the effects of selling are known. It can be done piecemeal, that is, starting the process, delaying the final decision until all of the facts are considered. That is not to say that the process should entered into just to gain insight and a valuation for the company. It should be entered into in good faith with the expectation that the result will be the company's acquisition unless there is some unforeseen issue that develops, or your expectation can't be met.

As far as it being the right time to sell within the context of there being qualified buyers and the timing relative to company valuation; there are qualified buyers and valuations for companies in the industry have held the line. I do not expect that to change, so the question about when to sell is more a matter of when is the right time for the shareholder(s) to sell, not whether or not there will be qualified prospective buyers, or are current valuations high or low.

What is the plan for the future? Without one, the ultimate success of the transaction will be less likely. Often, the entrepreneur knows only one life; that is, following a path of building a company with all of its struggles, hard work, some disappointment, but usually resulting in the ultimate state of success. Time has passed and suddenly, it seems like selling the company may be the right thing to do. If all the signs point to a successful transaction, one still has to figure out what to do next: start a new venture (in a different industry, of course), fulfill one's dreams of climbing Mt Everest, volunteering in some worthwhile activity. Whatever one does, it has to be realized that life will be different after the sale of one's company and that choosing and following a new path, while different, can still be rewarding and fun, too.

None know when life's circumstances will be such that a company should be sold, so it is wise that any company always be in a state of readiness if that should happen. A state of readiness would include: company records being current, management in place that can fill the gap, a list of add back items that will provide adjustments to profit for valuation purposes and finally, the designation of a competent group or person that will manage the sale of the company.

How much money is enough? It is different for each, but coming to grips with this question will be key for a successful transaction. Money, while a consideration for many entrepreneurs, is frequently not the sole or most important factor in becoming an entrepreneur. Control of one's own destiny for many is, at least, as important as money. Along the way, however, money takes on a life of its own. If a company is successful, one can live *"the good life*." Money is available and to some, seems to be *infinite*, even though it is *finite*. So, when considering the sale of one's largest asset, it becomes obvious that money is no longer infinite, it is finite, just as it has always been. Going forward, this perception adjustment will be necessary. For most, the proceeds from the sale will be more than ample to proceed with a reasonable lifestyle, or to finance a new venture. That lifestyle or venture has to be considered within the context of: time commitment, stress, risk and other opportunities that have appeal, but can be realized only if the company is sold. If a seller concludes that what is being offered does not meet expectation or needs, the choices are to continue with the company, making the necessary changes that will increase valuation within the short-term, or to simply abandon the thought of selling the company for the time being.

Is the seller open to some compromise? Without it, the transaction has little chance of success, or even getting off the ground. Sellers and buyers, if attracted to one another, will have ideas about some of the issues that arise that are different. Dealing effectively with those differences is called *negotiation*. If one or the other side is intractable, the process will likely stall and die. It is always helpful in any negotiation to put oneself in the other person's shoes, trying to look for what is important for that person. If that important issue is found and appreciated, perhaps there can be some compromise on that issue, allowing the opportunity for further compromise for an issue important to the other side. Much of the time, gaps can be bridged; sometimes they can't be. Usually, intractability on one or each side can be sensed early on in the process. It happens that way some of the time; however, in some cases, each side has gained insight and appreciation for the other and they return to the table in months, or even years after the first attempt.

Understanding risk and residual risk is essential. Acquisition can be risky business. It is far less risky to each party when the risk is discussed, appreciated and evaluated with reasonable counter-action included in the transaction documents. Risk should be faced for what it is; not necessarily what it could be. It should be neither overstated, nor understated. Sometimes bad things happen, but usually there can be agreement so that when the unexpected does happen, provision can be made so as to minimize the effect for each party. There are numerous examples of bad things happening, yet the acquisition continues on as a long-term successful project because each side negotiated in good-faith and provided for things going not quite as planned. Face the risk issues rationally; discuss them and provide for the eventuality if one surfaces.

Being prepared for and wanting the buyer to succeed. A successful acquisition requires that both the buyer and the seller succeed and that each reaches their expected goals. To the extent possible, the agreement should be structured so that goals are met and success is mutual. Each needs to work toward the other's success. Without this, the acquisition will be less successful for each.

The Buyer's Commitment and Qualification. Without each, the effort will not work.

The prospective buyer must have more than the desire to acquire; there must be the financial qualification to undertake the project. This needs to be conveyed to the seller at the onset of discussions. Without the willingness to substantiate qualification, the seller should discontinue the effort until that qualification is substantiated. The buyer too, should understand that their lack of qualification will cause the transaction to fail, so that qualification needs to be determined early on. The desire and commitment to buy is not enough. Furthermore, qualification to get the transaction completed is not enough either. There has to be financial qualification and commitment to grow the acquired company if there is to be any purpose in acquiring the company. It just may be that if a prospective buyer answers these points honestly, growing through an accelerated marketing plan may be the better option.

The buyer's vision. Is the motivation for acquiring a company to ramp up revenue, to eliminate a competitor or to feed ego; or is there a vision for the exponential growth of the combined companies, leading to greater profit and opportunity? This is an important consideration for any prospective buyer and it needs to be given very careful thought. Leaping into a pointless acquisition can ultimately lead to stunted growth and headache for a buyer.

Learning from past acquisitions. People learn by doing. The same applies to those that acquire companies. A prospective buyer needs to look back, figuring out what worked and what did not work. While each acquisition is unique, there are some features that are similar for each one. Build on what was done well and what could have been done better. Experience shows that buyer's regret is frequently due to not having vision for the combined entity, a poorly executed transition for the combined companies and failure to exploit the strength of the combined companies. A buyer should be able to look back after one year, three years and five years, thinking that the acquisition, while not trouble free, was a wise move.

How significant will this acquisition be for the buyer? If it a make or break project, then there is much reason to approach the acquisition with care and to redouble the effort to make sure that all of the bases are covered. If there are remaining doubts after being as careful as practical, the better course may be to not proceed with the transaction. As painful as that would be, it is probably better that getting in too deep and causing failure for all concerned.

Understanding the selling company's strengths, weaknesses and the goals of the seller shareholder(s). This is a must for the prospective buyer to be successful. If it is perceived that the seller's goals will not be attained, steps need to be taken to realign those goals. For the transaction to be successful over the long haul, complete honesty is required by the buyer, discussing the vision for the combined entity. When the visions of the buyer and seller are aligned, then the transaction should proceed. Absent that alignment, it should be suspended.

What does a prospective seller's or buyer's negotiation style indicate?

It may not be *love at first sight*, but soon after serious discussion begins there should be some general respect and appreciation for each other's approach to the discussion. Aside from honesty and integrity, it is always helpful when there is mutual appreciation and respect for the other's accomplishments. *Bullying* is not a tactic that will lead to a mutually good transaction. Past mistakes or failures should be discussed only as they apply to the transaction at hand. In the end, mutually good transactions that work for the long-term require this mutual respect and professionalism.

The current state of M&A activity within the building services industry.

Activity continues at a moderate rate, although, much of the activity appears to be spearheaded by equity groups looking to gain a foothold in the industry. Strategic groups too, are somewhat active. We believe that there are some *closet* sellers, still not sure whether or not this is a good time to test the water. We at *GPA* think that it is a good time, but only if it is the right time for the seller. Overall, we see both investor and strategic buyers that appear to be qualified and eager to consider an acquisition.
Commercial banks seem to be loosening up a bit, making an acquisition that makes sense a possibility for a strategic buyer with a history of good performance and with the ability to provide some cash contribution for the project.

We at GPA remain quite busy with projects and continue to discuss possibilities with both prospective sellers and buyers.

A word about valuation with regard to the buyer's company valuation. Generally, the valuation will not reflect an acquisition addition until the acquisition is fully integrated and there is a history of performance for the combined entity. This may take years, not just months. So, *flipping* is not necessarily a good idea.

We feel that the general state of the economy has a significant bearing on the activity within the M&A sector of the industry. There appears to be some economic improvement, but we are hard pressed to say that it is a trend yet. We are, however, *cautiously* optimistic about what lies ahead.

There is a new face at GPA. It is my pleasure to welcome *Christi Rohmer* as an associate with *Gary Penrod and Associates*. Please read about Christi in the attached note about her. I am very happy that she has joined us and anticipate that her skill, experience and knowledge will benefit our clients for a long time to come.

I have also attached some brief information about a few of the companies that we are currently representing. Please contact me directly if you want to discuss any of these offerings in detail, or if you want to discuss valuation for your company and its prospects for a successful sale. Contact me also about any comment or question about what I have written here. I will be happy to discuss any matter in depth.

STAY TUNED!

Gary