A TobinLeff eBook

# 12 Keys to Profitable Acquisitions

## A BUYER'S GUIDE

Practical advice for agency owners thinking about increasing the value of their enterprises through acquisitions

TobinLeff

Building & Monetizing Business Value℠

Copyright © 2018 by TobinLeff, LLC

How can an acquired company enhance your value drivers and value proposition? How can you find opportunities where "1+1 is greater than 2"?

# 12 Keys to Profitable Acquisitions

Acquiring another agency, niche boutique practice, or even a sole practitioner with an established book of business can be an excellent strategy for fast-tracking the growth of your firm, increasing top-line revenue and profitability, and adding talent and capabilities to propel your enterprise to the next level.

And acquiring a firm may be more affordable than you think. Most deals are done on the basis of an upfront payment (sometimes surprisingly small) plus a performance-based earn-out, thereby minimizing your risk and incentivizing the seller with the chance to participate in the upside potential of the combined companies.

But an acquisition is not for the faint of heart. It is a process that requires skillful negotiating skills, extensive due diligence, soul-searching, and the willingness to take a chance.

But with proper planning and the right advisory team on your side, a successful acquisition can pay significant dividends and enable you to achieve your financial goals much more rapidly than attempting only to grow your business organically.

Here are a few tips for laying the groundwork for a successful acquisition:

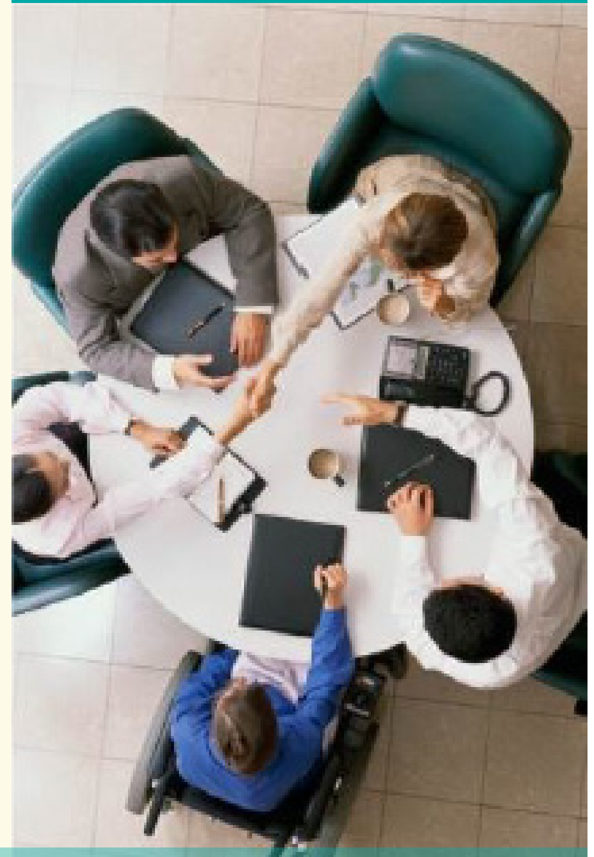
Copyright © 2018 by TobinLeff, LLC

1. ***Vision*** – Why do you want to do the deal? What is your vision of what you think you can accomplish together? Within a year? Within 5 years? Crystalize your vision. Articulate why the lives of the principals and key employees of the companies you acquire will improve when they join your business family. Where are you going? How will you get there? What capabilities and services can you sell to the target firm's clients, and vice versa? What will it mean for all stakeholders when you achieve your vision? Don't try to acquire just for growth—make sure it's for strategic reasons that align with your vision.

2. ***Value proposition*** – Clarify your value proposition for the principals of the companies you want to acquire. What can you offer them? Will they...
   - Monetize their business interests?
   - Get an equity stake in a larger, growing enterprise?
   - Achieve greater financial stability and security?
   - Work on larger and more prestigious accounts?
   - Be relieved of management responsibilities?
   - Have additional resources to grow their areas of expertise?
   - Become part of a successor management team with the opportunity to buy you and/or your partners out down the road?

3. ***Profile target companies*** – Defining the desired capabilities of the target companies (branding, design, analytics, PR/content, SEM/SEO, web design, etc.) should be easy. But you need to go further and create a detailed profile of target prospects, as well as the qualities and characteristics of the principals and key employees you want to attract. For example, are you seeking...
   - Senior managers with proven rainmaking skills?
   - A strong reputation in a vertical niche?
   - Specialized expertise in SEM, branding, PR, etc.?
   - Entrepreneurs who can be your pathway to a future exit?

What can you offer the selling owner that will change his or her life… and offer greater career opportunities for their employees?



Copyright © 2018 by TobinLeff, LLC

What value should be placed on the target firm? Should you take into consideration the future potential of the business, or just historic financial performance?

**4.** ***Leverage*** – Seek opportunities where you can leverage your cash and resources. Most acquisitions can get done with less than 33.3% of the selling price paid in cash at closing. If you have good credit, banks are typically willing to loan money for the down-payment and needed working capital. Use the acquired companies' future cash flow to provide funds for deferred payments and earn-out payments. Also, try to structure earn-out payments as ordinary income to the sellers so that you can deduct the payments.

**5.** ***Look for Arbitrage Opportunities*** – Depending upon the size and value drivers of the companies you want to acquire, you may be able to buy companies at a low multiple of EBITDA and later turn that net income and EBITDA into a much higher multiple when the acquired company becomes part of your enterprise. You pocket the arbitrage between the multiple you paid and the multiple you command when you sell.

**6.** ***Deal structures*** – Learn what you can about the acquisition process and the various approaches that can be used to compensate the seller for the value of his or her business, such as:

- Upfront payment
- Guaranteed payments over time
- Earn-out payments based upon the performance of the acquired company
- Bonuses tied to benchmark goals
- Equity in your company
- Stock options
- Units in a phantom stock plan
- Deferred payments

Copyright © 2018 by TobinLeff, LLC

7. ***Model the resulting enterprise*** – What will your business look like, from a financial perspective, post-acquisition? What financial synergies can be realized by combining businesses? If you are buying a firm "across town," does it make sense to combine offices, or have separate operations? If the target company is in another state or country, how will you operate?

   What about your respective approaches to pricing? Will the clients of the target firm be okay with your billing rates, fees and retainers? Will you need to adjust salaries and benefits? Can you increase profitability by passing business between profit centers?

   Create a financial model of your expanded business, incorporating all the carry-over costs of the acquired business, anticipated savings, any necessary adjustments to salaries and benefits, billing and utilization rates, and the various costs and debt service associated with the deal.

8. ***Safeguards*** – When buying a service firm, you need to build in safeguards to help assure that you are only paying for business that transfers and persists. That's why it's common for a large portion (50% to 70%) of the total deal consideration to be based on future performance or benchmarks. Try to design earn-out provisions that are based on easy-to-measure metrics, such as net income, EBITDA, and/or Adjusted Gross Income. Buyers typically prefer to base earnouts on net income or EBITDA to help assure cashflow to service debt. Most earn-out schedules are for 36-mounths.

9. ***Chemistry*** – Good chemistry between the seller's and buyer's management teams and employees can be even more important to the success of the transaction than financial potential. Take your time to get to know the key players. Consider working on projects together before you finalize the deal. Interview their key employees. Explain to them your vision, policies, procedures, and expectations. Ask about their culture. Do you share the same general attitudes toward flex time? Employee productivity? Client service? Profit sharing and bonuses? Employee training? Community involvement? As part of the due diligence process, consider holding "team building" exercises to see how well the respective management teams "click."

What safeguards can you put in place to protect your business, in case the deal doesn't work out?

Copyright © 2018 by TobinLeff, LLC

Don’t go it alone.

10. ***Due diligence*** – Go deep on your analysis of the opportunity. Study all aspects of the company, and spend real time verifying the accuracy of information you’re provided. Analyze their business model, contracts with clients, agreements with employees and vendors, and any other factors that can help predict future performance. Look for roadblocks or deal killers that you can uncover before you go too far into the process—such as excess debt, low staff utilization rates, high ratio of low or non-billable employees, over-servicing of clients, sloppy financial controls, or long leases (recognizing that some of these factors can be “fixed” with proper management). You need to be sure you truly understand the seller’s motivation for selling.

    Below is a list of “value drives “that impact value. How would you rate the drivers of the target company? How will the acquisition enhance your value drivers and value proposition?

## “Value Drivers” that Impact Value

- Consistent cash flow & profitability
- Growth
- Culture
- Size
- Strength and experience of remaining senior management team
- Limited dependence on selling shareholders
- Retention of key employees—“golden handcuff” incentives for top managers to stay
- Market specialties and niches
- Quality and uniqueness of services
- Longevity and diversity of accounts
- Sales trends and growth potential
- Systematic approach to new business development
- Reputation and goodwill
- Brand and protection of intellectual property

Copyright © 2018 by TobinLeff, LLC

11. ***Integration*** – Develop a detailed plan and process for how you'll integrate the company into your enterprise. Explore creating account and business development teams with members from both companies to build relationships internally and externally.

12. ***Don't go it alone*** – Acquiring a company can consume you. It's very hard to do properly while you're still trying to run your own business. Just as there's a reason your clients hire you for the expert services that you provide, you should consider seeking help from the expertise of a Mergers & Acquisitions professional or consultant for the best results.

## About TobinLeff

TobinLeff (formerly The Tobin Group) is an exit planning, consulting and M&A advisory firm that helps owners of advertising, PR, digital, and marketing services agencies build and monetize business value. To help clients enhance enterprise value, we craft strategic plans, design both phantom stock plans and equity-based incentive plans to reward and retain key employees, and provide M&A advisory services to acquire companies and acquihires. To help clients convert business value into personal wealth, we craft exit plans, design and implement management buy-out plans, and provide M&A advisory services to sell to outside buyers and private equity groups. Over the past nine years, we have helped more than 100 agency owners with consulting engagements and M&A transactions. All the partners of TobinLeff have owned agencies. Please visit our website at www.tobinleff.com for information and case studies.

TobinLeff

Building & Monetizing Business Value℠

412-515-0120

www.tobinleff.com

info@tobinleff.com

Copyright © 2018 by TobinLeff, LLC