



Successful Acquisitions

Avoiding the pitfalls
to execute successful
deals



....well considered acquisition strategies and well prepared acquisition processes are key if an Irish buyer is to have a fair chance of delivering on their acquisition goals to support their overall strategic plan and add capital value to their business.

Anya Cummins, Partner, Head of M&A

The Irish M&A landscape

A certain level of mergers and acquisitions (“M&A”) activity is expected and ultimately required in a normal functioning M&A market. It is an important growth driver, it allows for retiring owner managers to extract equity from their businesses and it caters for general divestment for those wishing to realise investments.

M&A activity tends to rise and fall in line with general economic trends, and from early 2009 to late 2013 M&A transaction activity in the Irish market fell to unprecedented levels; outside of stressed and distressed opportunistic scenarios. This gave rise to a hugely pent up demand for M&A activity, with transaction levels returning to pre 2007 highs in 2014 and 2015. 2015 in particular saw a significant surge in M&A activity, while H1 2016 deal volume was slightly more subdued levels. However, while the full impact of Brexit remains unknown, there are a number of positive indicators suggesting continued strong levels of activity in the Irish M&A market.

M&A market update: continued growth in activity, but some challenges driven by global market activity

- Irish M&A activity reached a seven year high in 2015. This was largely driven by a more favourable economic environment, improved trading performance in businesses, well capitalised corporates, a strong private equity market and the availability of financing to support transactions. H1 2016 deal volume has been reasonably steady, and the expectation is that there will be similar levels of activity in the second half of 2016
- Outbound M&A is a key feature of the Irish market – with Irish corporates continuing to be active buyers of businesses internationally
- The Technology, Media and Telecommunications sector (“TMT”) accounted for almost one third of deals by volume in 2015, mainly driven by large international corporates bolting on high growth indigenous Irish businesses. This trend looks set to continue with strong TMT activity levels in H1 2016. A range of other sectors are also active including business services, leisure, pharma, consumer and financial services. In terms of deal value, life sciences and pharma dominates driven by a small number of high value transactions
- Deals at the mid-market (€15m to €250m) were strong in 2015 – with consolidation by mid-market companies as well as private equity transactions continuing to be an important driver of domestic deal activity. In H1 2016, while declining slightly, mid-market deals remain as a key driver of M&A activity.
- Private equity activity is also growing in value rather than volume – reflecting a move from stressed private equity transactions to larger scale growth capital fundraisings and a return of the MBO. There were six private equity deals in the top 10 transactions in H1 2016 (compared to 2 in H1 2015), including CCI’s high profile acquisition of AA Ireland and we are continuing to see strong levels of private equity invest in the Irish mid-market.

What are some of the key drivers of successful acquisitions?

Acquisition or buy and build is at the core of many Irish business's strategies for growth. If well planned, executed and integrated; a successful acquisition can be a significant accelerator to organic business growth as well as in many cases offering the business access to a product, service, market, technology or capability which is more difficult to access organically.

Management teams considering acquisitions should ask themselves some key questions to aid in their evaluation of whether any particular target acquisition, or indeed an acquisition strategy in general, makes sense and is likely to be value enhancing to their business overall. These include the following:

FIVE KEY QUESTIONS

1 **What is our overall growth strategy and how do acquisitions fit into this?**

It is useful (whether considering acquisitions or not) for any business to prepare a five year strategy and evaluate the ultimate vision for the business. The capability of the business to achieve this plan organically and the ways in which acquisitions may make sense can then be carefully evaluated against an overall well-considered strategic plan, rather than in isolation or opportunistically.

2 **Can we use acquisition to acquire skills or assets which are currently a gap?**

This is one of the most cited (and valid) reasons for considering an acquisition and typically includes acquiring equipment, technology, people/capability etc. which the business either cannot access organically or which would take significant time and investment to develop.

3 **Are we seeking to accelerate access to a specific target market or product area?**

Acquisitions as a means of entering new geographic markets is a key driver of M&A activity. Similarly acquisitions can enable a business to access a new complementary product; typically which can be sold through existing channels to market. In general, having a strong local management team or implanting a member of the Buyer's management team into the target entity will help maximise the success of acquisitions in other markets.

4 **Will the acquisition improve the target company's financial performance?**

Acquiring corporates often seek to acquire businesses where there is a clear opportunity to improve margin and drive better financial performance. This may be through cost cutting or by leveraging their expertise to generate superior financial returns. Carefully evaluating the potential synergies and anticipated profitability of the target business and assessing the financial returns under a number of scenarios (base case, upside and downside) allows an acquiring business to assess in detail the potential outcomes post transaction, and to ensure that a deal is structured to take account of these.

5 **Do we have an internal acquisition champion?**

Having a senior member of the management team who "owns" the acquisition process and is heavily involved in assessing the acquisition opportunity, structure and potential returns alongside the company's advisors greatly improves the chances of a successful transaction. Maintaining momentum during the process is also of critical importance – deal fatigue is one of the key reasons deals fall over mid-process where both buyer and seller lose interest in the transaction and appetite can wane. The deal champion (alongside the advisor / project manager) is key to driving the deal to meet timelines and ultimately to completion.

Approaching an acquisition process to maximise success



A deal process can be all consuming for both buyer and seller, and often the senior management team can become distracted on the internal processes and the running of the business becomes less of a focus. **Preparing carefully for a deal and ensuring that continuing to drive underlying profitability should be the key focus is critical.** In some cases this means freeing up specific members of the management team on either or both sides of the process to focus on the deal, enabling others to prioritise day to day business and customer relationships.

Misalignment of valuation expectations can be one of the challenging aspects of deal negotiation, particularly in a buoyant market where valuation multiples are high. Early agreement of the valuation alongside carefully understood assumptions can help ensure that both buyer and seller are aligned on the deal structure at an early stage in the process. Planning the acquisition process to include a detailed heads of agreement which addresses all of the key terms that underpin the buyer's valuation assumptions, including factors such as net debt and normalised working capital which are adjustments to price but the implications of which may not be fully appreciated by the seller at the point of engagement, is also recommended. **Earn out structures and other incentivisation structures** providing upside for the exiting shareholders and/or the management team can also be very effective in bridging valuation gaps.

Another reason acquisitions fall over during a process is so-called **price chipping by the buyer**; whereby the financials presented by the seller don't stack up to due diligence or fundamental issues are discovered mid-process which lead to a reduction in valuation which a seller is not willing to accept. For the seller, the onus is on them to prepare for diligence thoroughly and present a robust picture of the business. For the buyer, a well-prepared buy-side diligence process and early identification of red flag issues identified can help manage the expectations of the seller.

Communication throughout the process and maintaining a strong working relationship with the management team on the other side of the deal is also of utmost importance. What is often forgotten in the midst of heated deal negotiations is that the two management teams (in most cases) need to work together post transaction to deliver on targeted returns. Using advisors or independent third parties (e.g. non-executive directors) to help manage the process and the negotiations between the parties can help to manage this risk. Communicating issues as they arise and keeping sellers informed of the process, approvals, funding and due diligence issues all help to encourage a smooth transaction.

Why do so many deals fail?

The stated statistics on the percentage of acquisitions that fail vary; but most market participants accept that at least 50% (some market commentators believe this figure is closer to 90%) fail to deliver expected returns. So why do so many acquisitions fail?

THE ACQUISITION DOESN'T FIT WITH THE BUSINESS OR GROWTH STRATEGY

One of the key reasons acquisitions don't succeed is that the acquisition target is too far outside of the core focus and core competencies of the acquiring business. Diversification should be intelligent; it should fit within the focused growth strategy of the business and bring a value-added benefit to the acquiring business which is clear and quantifiable.

OVERPAYING OR A DEAL STRUCTURE WHICH DOESN'T WORK

Businesses can get carried away with competitive auction processes and overpay for a target; which makes commercial returns difficult to achieve from the outset. Similarly deal structures require careful consideration. For example, an earn-out which locks in the management team of the target entity and aligns the goals of the team with those of the buyer (i.e. profit growth) can work very well if structured correctly. A wholly upfront payment to a shareholder who can then exit but was key to the business on the other hand can be catastrophic. Tax planning should also be an important element of deal structure consideration.

CULTURAL FIT

Often underestimated; the cultural fit of the two businesses coming together is key and requires early assessment – often between the shareholders of each business to determine if realistically the teams, culture and approach to business of the two companies can come together in a way that will allow for growth and value creation.

A CLEVER APPROACH TO INTEGRATION

In some cases, leaving a newly acquired business to stand alone, at least in the short to medium term, can work much better than integrating quickly without a well-considered plan or integrating when there is no commercial need to do so. A buyer can often benefit from taking some time to really understand how the newly acquired business functions and what works well instead of blindly making significant changes which may fall flat.

The statistics are clear – acquisitions can be difficult to execute successfully and post execution, the majority of acquisitions fail to deliver expected returns. Therefore, well considered acquisition strategies and well prepared acquisition processes are key if a buyer is to have a fair chance of delivering on their acquisition goals to support their overall strategic plan and add capital value to their business. Preparation and early identification of issues is key, and deals need to be structured to manage risk for the buyer while also satisfying the seller or providing some upside post deal.

The underlying fundamentals driving activity are strong and funding environment to support buy-and-build strategies is particularly strong in the current environment, both in terms of debt and equity. Where successful acquisitions can be identified superior returns both in terms of net profitability and ultimate capital value can be achieved within a relatively short time period.

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