

TECHNOLOGY ACQUISITION UPDATE

The Current Opportunity in Sub-30 Acquisitions

by Thomas V. Metz, Jr.

An opportunity only exists if you can see it. And it will be seen only if it is looked for. Sometimes an obvious solution becomes obvious only after we have found it.

— Edward DeBono

The current economic environment presents remarkable opportunities for companies that can capitalize on them. The economy is in turmoil. Where there is turmoil, there is uncertainty. And where there is uncertainty, there is opportunity.

Now is a time for action, not a time for hunkering down. Those companies that act in this time of uncertainty can establish beachheads in niche markets that will be poised for growth as the economy recovers. This is an auspicious time for acquisitions.

The Growth Imperative

A company must grow in order to sustain its competitive edge and to create value for its shareholders. Higher profits result from reducing expenses and from increasing revenues. It is much easier for management to cut costs than to generate new revenues. Growth companies must enhance the top line and strategic acquisitions are an excellent tool for increasing a company's revenues.

The Market Opportunity

Many smaller firms need to be acquired in order to reach the next level of growth. Having worked in the sub-\$30 million acquisition market space for more than 25 years, I have significant insight into the dynamics of the companies in these markets. These are entrepreneurial firms and their growth is often limited by their sales and marketing resources. An

alternative growth scenario is to team up with, or be acquired by, a larger firm with greater sales and distribution capabilities.

In the current economy, cash flow is being squeezed and small firms are finding it difficult to raise expansion capital, either debt or equity. As a result these firms are more amenable to the idea of being acquired in order to continue on their growth paths. In addition, being acquired reduces a firm's risk posture. Sometimes being acquired has the same effect as a financing transaction: it provides the resources to take the company to the next level of growth.

The Benefits of Small Acquisitions

Small acquisitions offer an effective and inexpensive way to establish beachheads in niche markets and help a company achieve its growth objectives. These niche firms can be built into larger enterprises. Remember that all large markets were small markets at one time.

Small acquisitions—\$5 million, \$10 million, or \$20 million in size—are attractive acquisitions for a number of reasons: they are less expensive, simpler to transact and easier to integrate. Plus, there are many more companies to choose from compared to large acquisitions. The market for small acquisitions has not been picked over.

The Challenge for Management

Sometimes management can be apprehensive about taking actions in a new direction. They may be more concerned about avoiding mistakes than making a bold move. There are risks associated with any new endeavor. However, risk is not something to be avoided. Risk is something to be dealt with, managed and minimized. If there is no risk, there is no opportunity. A company does not grow with risk-averse behavior.

Playing “Not to Lose”

I have been a competitive tennis player all my life. In the early days I lost a number of matches by playing “not to lose.” I would get ahead in a match and then play safe—trying not to take any risky shots. I learned this lesson the hard way. One must play to win. One must take advantage of opportunities when they arise. You must take some risks. Take the smart risks. If you don’t, your competitors will eventually pass you by.

A number of CEOs that I have encountered have done a good job of building their companies, but now growth has tapered off. They are more concerned with trying to hang on to market share rather than aggressively seeking out new markets. These CEOs are playing “not to lose.” Eventually the company will suffer from such a risk-averse approach.

Imagination at the Edges

A company’s opportunities for growth often lie outside the confines of its current industry description. Moving into new and adjacent sectors enables a company to gain new customers, additional revenues, new talent and broader capabilities.

The edges of a market space are always gray. And these gray areas are where the new growth is developing. We look into emerging and fragmented spaces. There are gaps in every market. We often find unusual opportunities for the firm to consider in these fringe markets.

The Metz Acquisition Strategy

Our strategy involves buying a target to gain a foothold in an adjacent niche market. These sectors are *adjacent* or *tangential* to a company’s primary market space. Even though these acquisitions may not be in the core market, they should still leverage the buyer’s strengths and competencies.

We are flexible and creative in how we view a company’s growth possibilities. We have different eyes than the company does, than does its internal team. We have fewer preconceptions and fewer biases. We do not let a company’s predefined criteria limit our creative ideas.

Many firm’s acquisition searches can be characterized by fits and starts. Our process is a dedicated, proactive effort to identify good candidates for acquisition. We canvas an industry sector, leaving no stone unturned. We reach out to companies that may not be for sale. The company that said ‘no’ to being acquired last year may be willing to discuss the idea this year.

In one assignment we investigated 190 potential targets. We studied 46 in some depth, resulting in 17 targets for serious consideration. Of these, our client successfully acquired two companies.

How Does our Strategy Differ from a Typical Search?

A typical acquisition search aims to strengthen an existing domain, while ours helps companies enter new domains. A typical search is characterized by well-defined criteria and a high degree of focus. Focus is, by definition, limiting. Highly focused strategies map out the ideal acquisition, but the ideal acquisition may not exist. Our acquisition strategy, on the other hand, is designed to help companies enter new markets and new domains.

Our activity is more of an exploration than a search. It is opportunistic in nature. We examine markets that you are not currently active in. We disconnect the dots. We look into other boxes.

Typical Objections

Over the years I have heard many objections to the idea of outsourcing the search for acquisitions. What follows are typical objections along with my responses.

“We can do it ourselves”

Many companies keep an eye out for acquisitions; however, our process is a more highly dedicated effort and a more imaginative effort.

- Most firms do not have the manpower to pursue a full-time acquisition search. We are not talking about dabbling. We are talking about a fully committed effort to

examine a variety of niche market opportunities.

- Most firms are not particularly imaginative with respect to acquisitions. However, we are not fettered by a company's criteria. We will show you things that are outside of your normal purview.
- I have more experience than most internal teams—25 years arranging transactions in these markets. Also, as an independent third party, companies are more likely to communicate openly with me than they would if dealing directly with a buyer.

The “we can do it ourselves” attitude is short-sighted and not in the best interest of your shareholders. Don't be opposed to outside help. Leverage the experience and skills of others. We can be an excellent resource for you.

“We see acquisitions now”

You only see the companies that are “for sale.” Many of these are underperforming or overpriced. The high quality companies are not out looking to be acquired. It is also likely that you are not seeing the truly imaginative deals.

“We know our space. We are very focused”

Of course you know your market intimately and you know who the likely acquisition candidates are. Focus is a good thing; but focus is not the only thing. Being opportunistic can pay huge benefits, especially in the current economic climate.

“We have a business development department”

We work as partners with your business development team, complementing their skill set and experience. We develop the imaginative acquisition ideas and the bus dev people review and analyze them in the context of your company.

Many bus dev people are constrained by criteria and by organizational dynamics. They do not want to appear imprudent or reckless. Their acquisition searches tend to be more conservative and more limited in scope. They are constrained by the company's mission statement, whereas we tend to look beyond the company's set criteria.

“We already have an investment banker”

A mid-sized investment bank will not typically seek out smaller acquisitions—the \$5, \$10, \$15 million-sized deals. Transactions in this range are too small to interest them. They cannot earn a large enough fee to make it worth their time and effort. We

specialize in transactions of this size and provide committed attention on every assignment.

“We don't pay retainers”

First of all, an acquisition retainer should be viewed as an investment, not as a cost. Secondly, perhaps you should rethink this policy. It all depends on what value you receive for the investment. Our acquisition exploration is an excellent value. We save you time and present you with creative acquisition ideas that you likely would not otherwise discover. It is money well spent.

Our Market Knowledge

I have been arranging acquisitions in these markets for many years and am intimately familiar with entrepreneurial firms and their growth alternatives. I know what their exit strategies are. I realize that many smaller firms have stalled; that their growth vector has leveled off. I know that being acquired is often the best way for these firms to resume their growth and expand into other markets.

I also understand the entrepreneurs' mindsets regarding risk—some are high risk takers and others are more risk averse. Recognizing the correct mindset early on can be a big time saver. Being acquired often makes more sense than raising capital for these companies.

Benefits

Better decisions are made when management has several alternatives to consider rather than just one. Most management teams have plenty of work to do without adding the burden of researching and screening acquisitions. Many in-house acquisition efforts get bogged down early on. When discussions begin with one company, all other efforts are put on hold. It is important to keep the process moving forward, to develop a number of acquisition alternatives.

We act as an extension of your team and identify targets that you would not normally identify. These are not the usual suspects. We give fully committed attention on these smaller acquisitions and we manage the process which saves you significant time and hassle. Exploring imaginative acquisitions is our core competency.

Side Benefits

Even if the company does not conclude an acquisition, a number of important benefits result from our opportunistic exploration. The company's management team will have evaluated and discussed a number of acquisition candidates. Management will have thought through the pros and cons of each acquisition with respect to the company's strategy. Acquisition discussions can help to clarify and refine a company's mission, goals and strategy.

Our process is about exploring new growth areas, not just acquisitions. It is a type of market research. It will stretch your thinking. The company may even decide to enter one of the niche markets that we identified on its own, rather than make an acquisition.

Summary

These economic times are characterized by uncertainty and therefore they are times of great opportunity. This is not a time to retrench. It is a time to scout out new market sectors and increase revenues through strategic acquisitions. These are the more creative acquisitions, not the usual suspects. Small acquisitions are an inexpensive way to expand into adjacent niche markets, establish beachheads, and set the stage for growth when the economy eventually recovers.

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