When the platform growth engine sputters, has the acquisition playbook gone stale?

Creating and executing an acquisition playbook for PE Portfolio Companies that delivers

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The platform ‘buy, build, and grow’ is the core strategy that underpins the investment thesis for small to mid-size private equity funds (PEs). Multiple expansion opportunities get presented in the form of Tuck-In(s), Bolt-on(s) and Add-on(s). Each transaction is different, however, and lean portfolio company management teams routinely stumble, resulting in periods of wayward platform stability and anxiety at the sponsor level. In a hypercompetitive environment of increased multiples, there is no room for error with the time and quality of platform integrations. Portfolio company leadership and operating partners need a playbook that is prescriptive, yet adaptive, and delivers desired outcomes.

This white paper is the distillation of our learning from numerous engagements where we were called in to assist. The narrative is sure to resonate with PE sponsors as well as with portfolio company management teams.

BUILDING OF A PLATFORM

To create a platform, a small-mid size private equity (PE) firm looks for an initial acquisition in a fragmented space within a specific industry. The sponsors identify from within or onboard, an experienced management team with a proven track record of growth. This investment is rapidly stabilized in line with the PE sponsor’s investment criteria in the first 100-180 days with defined systems and standard operating procedures (SOPs). With the build process completed, the platform serves as the foundation for a roll-up of other companies within the same space. Value creation happens through synergies harnessed by way of acquisition and building a critical mass with a robust and scalable operations support structure.

ACQUISITION PROCESS BY A PLATFORM PORTFOLIO BUSINESS

Once the first company is acquired the platform building exercise to merge or acquire additional target companies follows a relatively standard process of:

- A broker or investment banker led outreach to assess the initial interest in the company from prospective buyers; this teaser, as the term suggests, is always an overly optimistic representation of the target.
- This is followed by a non-disclosure agreement (NDA) by interested buyers who wish to review further, and, who receive a confidential information memorandum (CIM); again, a compilation of ‘hockey stick’ type future growth charts to a tepid historical growth.
- The platform management team, supported by the sponsor’s operating team, go through a ‘part-art and part-science’ process with limited data room and personnel interactions to convey an expression of interest (EOI) and/or letters of intent (LOI).

- Assuming the competition falls wayside, the due diligence process kicks off to ensure all requirements by the buyer are met and to ensure the maximum value and cleanest structure are achieved.
- Finally, the business case gets approved by the investment committee, the transaction closes, and the integration process commences.

This process, despite prior experience of a PE sponsor, long hours of analytics, and inclusive of third-party support, is susceptible to overlooked cues during an enthusiastic buying process. The PE industry's acquisition process is generally overweight on the financial, tax, and legal due diligence and has significant shortcoming when it comes to the following areas:

- **Operational Gaps** – while the acquiring platform has been stabilized to a certain specification, the target acquisition may be completely out of sync with key business processes of customer acquisition and fulfillment of delivery of goods and services

- **People Gaps** – an entrepreneur looking to cash out seeds a sentiment of uncertainty for the management and preparing the business for sale virtually guarantees an underinvestment in people

- **Systems Gaps** – while a platform company will invariably bring the target on to its systems, there are vulnerabilities and inconsistencies that can delay and create expensive integration pitfalls

As the platform company seeks value generation opportunities through bridging these gaps, the journey can be fraught with pain and uncertainty. While the cost of filling these gaps can be marked as 'one off' and therefore slotted 'below the line' for financial statements (i.e. AEBITDA), multiple periods of excessive operational costs and deceleration of platform growth seriously handicap investment realization and, ultimately, impact fund performance and realization of the investment thesis.

This can be avoided through a "rapid operational due diligence assessment" -- depending on the nature and size of acquisition – which can be accomplished in under a week and well within the due diligence time frame. In addition, this exercise can also deliver a prioritized roadmap of critical integration factors. The success of platform integrations is determined by steps taken before the transaction closes. Efforts post-transaction are costly afterthoughts.

SPECIALTY TOYS AND GAMES ACQUISITION

- Hired by PE to assess the business model built on royalties on acquisition of novelty ideas and financial control processes maturity
- Conducted a fast-track assessment through targeted questionnaire for efficient facetime with company leadership; validated the model that accelerated the decision-making process

AUTOMOTIVE PARTS DISTRIBUTION

- A midmarket PE was bringing two identical aftermarket businesses with common customer and products footprint
- Mapped customer fulfillment network; Conducted distribution center benchmarking to identify flagship facility, wind-down plan for redundant distribution centers; baked in capital investment and scenario analysis

BEHAVIORAL HEALTH ACQUISITION

- The platform management was keen to pursue a bolt-on. However, the PE Sponsor who had familiarity with the SLKone team through prior successful integration, wanted an objective review of the target and, if it justified the investment thesis, build an integration roadmap
- After conducting a rapid assessment of the operational and financial performance of the organization's recent history, it was determined the businesses performance had dropped off significantly from the initial CIM represented growth prospects
- Further, operational strains from key contract renegotiations and business model changes had distracted the company from ongoing operational performance. The Target was deemed to require far more investment and attention to be a viable acquisition given recent performance – saving millions in purchase price and ongoing investments to prop up the business

ACQUISITIONS COME IN DIFFERENT FLAVORS

Once the platform is stabilized and is actively seeking acquisitions, the opportunities come in a variety of flavors. Typically, a playbook gets developed with an idea of 'rinse and repeat' process steps. However, just as there are different horses for different courses, the integration playbook will get played differently. Some of these types and flavors include:

- **Tuck-In(s)** – As the term suggests, such acquisitions are to be "tucked in" under the infrastructure of the platform company. The principle characteristics of a Tuck-in target are they are smaller in size compared to the platform, cover a different geographic footprint, but have a similar customer profile. They generally have a principal entrepreneur as the leader but possess limited management depth, are absent of core processes, and are underinvested in assets and systems. Top-line or revenue increases through customer acquisition is often the primary driver over EBITDA accretion. Nimbleness and agility as managed by the entrepreneur are generally the hallmark, but also are limiting factors for future growth.

- **Bolt-on(s)** – These are more strategic buys with higher maturity profiles than Tuck-Ins with complementary services, technology, or geographic footprint diversification as the primary drivers. Bolt-on(s) are characterized by relatively slow-paced, capital-starved, stunted-growth organizations, with legacy management teams, but often have strong, profitable customer relationships. These are generally EBITDA accretive from day one but unsophisticated financial systems, unsupported IT systems, and a lack of internal controls can be a drag. Lower valuation of a Bolt-on is a major attraction for the platform.

- **Add-On(s)** – With consolidation investment strategy at the focus, an Add-On presents an attractive growth opportunity for the platform. Unlike a bolt-on or a tuck-in, an add-on acquisition can open diversification avenues for the acquirer. These targets are generally larger, and at times, are comparable in size with the acquiring platform. These acquisitions are few in frequency and availability but come with a stronger infrastructure and good management teams. However, an add-on acquisition could fetch a premium valuation in the marketplace and be cost prohibitive for a PE or platform company.

- **Roll-up(s)** – Yet another form of acquisitions that is a small minority for small-mid size PEs due to its execution difficulties. Usually, roll-ups are aggregation of fragmented industries brought under a brand umbrella by financial buyers. Multiple strong management teams with few common themes make it very challenging to achieve full integration. Roll-up(s) are generally characterized by long-haul ownership of financial and operational partners.

WHY THE ACQUISITION PLAYBOOK STRUGGLES

A playbook that was created and tested for the first acquisition does not survive with a new variant flavor of acquisition. Frequently, platform management teams attempting a “cookie cutter” playbook approach struggle to effectively integrate the target. The outcomes are a stapled set of disparate processes and operating styles versus a truly integrated platform. A telltale sign is excessive below the line costs for repeat external consulting interventions that are often questioned by future buyers - often larger, more mature PE houses and strategic investors.

We have repeatedly observed the following patterns of struggling integration process:

Tuck-In(s)	Bolt-On(s)	Add-On(s)	Roll-Up(s)
• A disenchanted ex-entrepreneur that cannot operate as an employee and may leave • Lack of shared tribal knowledge beyond the principal	• Capability gaps below senior management tier • Weak internal controls • Customers that remain loyal to the target and are unwilling to switch to be supported by the platform company	• Culture clash between platform and Add-On management • Difficulty in adopting to platform infrastructure • Legacy processes continue to co-exist • Lack of x-learning of best practices • Heavy SG&A costs	• A fragmented business with competing priorities versus a unified brand • Absence of common infrastructure and excessive operating costs

CREATING AND EXECUTING AN ACQUISITION PLAYBOOK THAT DELIVERS

Our experience working across a large spectrum of small to mid-size private equity sponsors and their portfolio company management in regional and national platforms ranging from $50Million to over $1Billion revenue in a variety of industries from healthcare, software, services, and industrial manufacturing have led to several common themes and best practices.

Education Services Tuck-In

- The flagship investment of mid-market PE in online education platform was challenged with weak financial function not ready to support the business growth for future acquisitions
- A fast track functional assessment in people, process, and systems maturity in conjunction with audit weaknesses led to management changes; buildout of integrated roadmap

Healthcare – Physicians & Lab Services Bolt-On

- A mid-size PE was doubling its pain management services platform through an acquisition to create a large
- Mapping of people-process-systems across for the acquirer and target organization; Buildout of integration playbook, program management, and executive coaching that resulted in the business fast tracking its performance goal

Industrial – Distribution Supplies Add-On

- Mid-market PE business doubled to $1.1B through a like-size acquisition; Sponsors were keen to understand best practices to integrate
- Conducted finance function and multi-facility footprint assessment; Recommended gaps and overlaps in people, processes, and systems usage; Designed future state org structure; Road-mapped distribution facilities transition

Industrial – Equipment Distributor Roll-Up

- A direct to factory equipment distribution business had rapidly grown through nine acquisitions within a short time but had not kept pace with the investment thesis
- Conducted a distribution footprint complexity assessment and benchmarked centers for revenue, cost and fulfillment metrics; Successfully program managed the performance turnaround

PROGRAM MANAGEMENT OF INTEGRATIONS

Poor execution of the best playbook can result in suboptimal integrations that take excessive effort on part of the portfolio company management as well as PE sponsors and do not generate anticipated value accretion. Integration requires disciplined program management objectively orchestrated across multiple functions. In our experience, the platform companies are generally very weak or entirely lacking a dedicated program management office.

The role is considered an ad-hoc activity, and we have seen the integration program management responsibilities managed by the CFO to the Business Development function to the IT leader to the operations head to the CEO. Clearly each of these functions have a day job to run, and with a 'hot potato' approach, target integration priorities get compromised.

Companies involved in successful integrations understand that disruption is unavoidable. Change is the very nature of expansion and rebuilding, and it's also uncomfortable for most people. Therefore, it's crucial to note that *collaboration – not technology – is the true driver of lasting change*. All the project management tools on the market today are only as good as the team behind their implementation and use. Organizations must care for their people first and support those efforts with technology instead of the other way around. When done right, the disruption caused by integration is muted, people and process are front of mind, and those impacted by the change view it positively and are still able to be successful within their clearly defined roles.

Typically, in a 36-60 months hold period, a successful platform will have 5-7 tuck-in(s) and no more than 1-2 bolt-on(s) or add-on(s). Therefore, it is not expected that integration program management will become a core competency within a PE-owned platform compared to large public corporations. More and more PE sponsors are relying on outside consultants' services to manage the integration process.

CONCLUSION

Organic growth is a secondary factor to the acquisition growth in platform value accretion. The integration speed and its effectiveness of the acquisitions can make big difference to the EBITDA multiple and the time to a successful exit. The seeds of flawless integration are sowed in the pre-transaction process and not post-deal close. A disciplined, multi-functional program management approach to execute integrations is necessary for delivering multiple expansion.

At SLKone, we understand that while this may all make sense on paper, it's certainly easier said than done, and we're here to help. Our consultants and subject matter experts are trained in a variety of industries and represent a deep functional expertise within many areas of business. We specialize in identifying the extent of integration needed and can roll up our sleeves to jump in and help – not just direct – but execute project and organizational management for successful integrations in the shortest possible time with the highest value creation.