iCEO Success Story

Acquiring XYZ or how to acquire a company with its own money

Context

XYZ is our main competitor, with similar activity than ours, but complementary and of great marketing interest. Its 2XXX revenue amounts to $110M and its financial result is nil. In 2XXX, XYZ shareholders gave up ownership, as a result of an LMBO (Leverage Management Buy Out), to 4 executives holding each 25% of the equity. The September 11, 2001 events produce tragic effects for the entire community of the US travel operators, and early November 2XXX, following a meeting in Chicago with XYZ's owners / managers, it happens that their company is for sale at $7.5M asking price. Our shareholders give us clearance to undertake such acquisition. I issue a conditional offer, at $7.5M price, subject to due diligence, after which payment terms will be exposed and final commitment given. The four XYZ shareholders agree.

Actions

Whilst performing due diligence, I detect that $1.8M in cash are blocked, of which $1M with USTOA (US tour operators association) to protect customers deposits against bankruptcy risks, circa $600K with their credit card operator and roughly $200K with various suppliers. Ourselves we have a $1M deposit with USTOA, which constitutes the statutory limit. Here comes to my mind the idea of recouping all these deposits and to use them to partially fund the acquisition. I check and then confirm the feasibility of such approach. Furthermore analyzing how XYZ is handled shows that numerous opportunities exist, to merge or optimize activities (marketing, accounting / Finance, IT, call centers, etc.) In my opinion delivering a $1.5M net profit is quite achievable at the end of year 1, tax free if we purchase the stock, which constitutes a reasonable assumption supported by the fact that no legal risk has been found during the due diligence. And lastly the XYZ shareholders agree to be partially paid in stock. Using the same criteria they have themselves used to appraise XYZ at $7.5M, and over valuating our technology at $50M, I end up appraising our company at $87M. Thus, and even though our revenue is only twice theirs, I valuate us at 12 times XYZ. To be honest I was expecting serious objections about my valuation. At the end of the due diligence, and after getting clearance from our shareholder, I articulate the final offer, which stands as follows:

- $7.5M for the entire stock, payable
- $2.5M in cash at closing,
- $2.5M in cash payable 12 months after closing, and

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- $2.5M in our common stock, only representing 2.86% of the total equity.

Appraising ourselves at $87M is not fought against, as XYZ share holders mostly focus on the cash portion of the deal. After a few minor modifications our offer is accepted.

Results and appreciation

By the end of January 2XXX the purchase is completed and XYZ belongs to us. Within 4 months the credit card processor is migrated and the $1.8M total deposits are captured back. 72% of the initial payment is done using XYZ's money. XYZ's CEO is quite effective and we keep him in his position. I rebuild with him the 2XXX budget and shoot for a $1.5M net profit. By the end of 2XXX, all restructuring operations are satisfactorily completed and the financial outcome is a net $1.8M profit, thanks to using losses carried forward. I use this result to fund 75% of the second payment. By the end of 2XXX, after I have left for other business opportunities, I learn that XYZ's profits have continued to increase. Thus the cash portion of the deal has entirely been paid with XYZ's money, in less than 18 months. Subsequent to this acquisition, our revenue jumps from $200M to $320M, or 60% growth. The profitability increase is harder to measure as our shareholder takes advantage of our external growth to reduce the commission rates granted to sell their products (which constitutes transfer pricing…but this is another story). However they demonstrate satisfaction by paying CEO and myself an exceptional bonus.

About the author:

Patrice Suncic has 32 years of international experience in corporate & general management. He is a aajor actor of change, able to transform business processes and generate improved efficiency, productivity and profitability, whilst maintaining social cohesion and has strong purchasing & negotiation skills.

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