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Five factors that can make – or break – an add-on integration

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Record valuations coupled with anemic global economic growth have pressured acquirers to buy and integrate multiple add-on companies into a single larger and more efficient platform.

While the add-on strategy has succeeded in some circumstances, many acquisitions do not meet their original expectations. Acquirers deploying this investment strategy can improve their odds of success, though, by taking heed of five particular areas.

1. **Pre-Close Planning**

The pressure to complete a deal quickly during a highly competitive bidding process often results in a delay in development of the post-merger integration plan until after closing. The longer the integration process, the costlier the integration and the issues that can arise.

Acquirers should develop an integration plan aligned with the investment thesis before closing. The plan should create focus for the combined organization and establish clear expectations for management's goals and responsibilities. The best companies adhere to disciplined timelines and priorities.

2. **Revenue Enhancement**

The goal of combining multiple entities generally is, of course, to take advantage of complementary strengths that produce more revenue combined than the entities could produce individually. Yet shortfalls in meeting revenue projections are all too common with add-on acquisitions.

Integrating new product lines can present operational challenges (such as mismatched systems, different compensation and commission structures, and conflicting pricing approaches), and persuading customers to buy from an expanded product offering might take longer than expected.

Acquirers that update systems, align compensation practices, and educate the sales force on expanded offerings up front can accelerate the realization of expected revenue enhancement.

3. Operational Improvements and Cost Reductions

Day 1 cost reductions can be among the surest value-enhancing strategies — if they are well planned. The newly combined companies often have duplicate functions that can be streamlined, and they will have greater leverage when they negotiate with suppliers. More important and more challenging, though, are the savings that can result from longer-term investments, including upgrades of people, processes, and systems.

The management team must focus on how best to cost-effectively use infrastructure to support planned growth. The platform company, for example, might need to negotiate with different state tax authorities about incentives, evaluate suppliers' proximity and costs, and weigh other factors before shedding duplicative facilities.

4. Working Capital Improvements

Acquirers sometimes home in on earnings before interest, taxes, depreciation, and amortization to the exclusion of working capital, but better management of working capital can free up cash for investment or to pay down debt and reduce interest expense.

This strategy might prove especially valuable in acquisitions involving a high amount of debt. In addition, tighter management of working capital can help limit future write-offs of receivables and inventory. Growing companies can cut working capital and reap savings in operating costs by, for example, reducing inventory and associated handling and storage fees.

5. The Go-Forward Tax Structure

Although much attention is given to setting up the optimal structure prior to closing, numerous opportunities and risks remain post-closing. These include evaluating tax methods, structuring and planning to minimize state and local taxes, analyzing state and local credits and incentive opportunities, and timely managing risks identified in the diligence process, such as sales-tax filings and various various state nexus exposures that result in additional sales-tax and state income tax filing obligations.

The bottom line: Proceed with caution. Add-on acquisitions have great potential to generate high investment returns, but they also come with significant risks. Getting it right requires experienced resources, forethought and discipline.

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