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Making Acquisitions Pay Off

For companies that do a lot of acquisitions, it is easy to get caught up in the chase of doing the next deal without spending enough time assessing how past acquisitions went.

Back in the late 90s and early 2000s, when I was working for two national alarm companies that were both heavily involved in acquisitions, I was never shown how the deals actually worked out although I brought many of the deals to each buyer. That was short-sighted because if I had seen data on how some of these acquisitions worked, I would have been a smarter buyer in the future. It is amazing how different 2 account bases can work out for a buyer!

What is true of alarm account deals I have read is true of almost all acquisitions. It is not a given that every acquisition will pay off. BDC Capital has recently published a "Change of Ownership Study" of a large sample of deals in various industries and found the following:

• 61% of companies that went through a change of ownership did not achieve the expected financial performance one year after the transition.

• On average, companies that went through a change of ownership missed their financial targets a year later by 40%.

Why do we get these kinds of results? What did the buyers do wrong? And how do the various segments of the security industry stack up on the acquisition front?

To answer these questions I am going to resort to a) parts of the same BDC study and b) my own anecdotal experience with acquisitions.

There can be several reasons why an acquisition does not give the buyer the returns expected. The buyer could have had their initial strategy wrong. They should not have bought that particular company. It was too far away. There was a bad culture fit between buyer and seller. Or, as my father drilled into me years ago, the buyer may have simply paid too much. This is more often than not a prime reason why deals don't work out. I am convinced this has happened in the alarm industry on many occasions over the last 10-15 years.

Let's look at deals in the alarm industry first. The woods are full of people who overpaid for alarm accounts. Imagine paying a multiple of 45X RMR and then adding on the cost to maintain that base for four years giving no chance of any return at all until halfway through the fifth year!

But it is the lack of good integration that bothers me the most. Although alarm accounts are quite portable and should be able to be bought and sold without a significant increase in attrition, many of us know that acquisitions of alarm accounts generally cause attrition to rise in the first year or so after. Why?

Some account bases, particularly smaller ones, have customers who are too attached to their previous owner.

But the bigger problem, in my mind is that most buyers, even the companies who say they are good at integration (I have found mostly that they are not good at it.), do not spend nearly enough time fully integrating the newly bought accounts onto all parts of their platform. Often the buyer bills, monitors and even services customers differently from the seller. If you spent $800 buying an account, why would you take the time to communicate these differences to the customers or spend $50 to call the account and properly introduce yourself?

The end result of all this is most monitored account acquisitions undergo higher than normal attrition in the first year after attrition. If the buyer has a 12-month attrition guarantee and holdback, then this higher attrition hurts the seller more than the buyer. Accordingly, as a broker, I work hard to protect that 10% attrition holdback for the seller by insisting that certain attrition related clauses be inserted into the purchase and sale agreement.

My own experience with the transition of integration companies has not been particularly good either. With integration companies, I would argue it is more important to hold onto the existing senior management team at least for a year or two than it is with an alarm company. These managers are likely responsible for why you bought the company in the first place. Secondly, some integration company buyers don’t take enough care with their communication to the customers and industry about the transaction.

Finally, if you are a buyer, have some respect for the processes, methods, and strategy of the seller. They must have been doing something right. Too many times, I have seen buyers of integration businesses be too intent on remaking the seller in the buyer’s image. It’s much better to leave the seller alone in the beginning than micro-manage it.

With fire companies, you might argue that the integration process should be easier. The inspection work is fairly standard and can be done by almost any qualified tech. The software platform and the people involved in the scheduling of service and inspections are important to get right in the transition. But these can be managed. It helps to hold onto the seller’s technicians simply because they are in great demand. But overall the integration process, I think, should be easier.

As for integrating guard companies, often what you are buying is several long-term guard contracts. So it is obviously important that the new owner makes contact with these customers and build a relationship. And, of course, looking after the newly acquired guard employees is important. Turnover in the guard business is bad enough on its own without having an insensitive buyer make silly moves.

There is lots of hype around doing M&A deals- particularly actually doing the deals- and when you add up all the brokers, investment bankers, lawyers, and accountants, there are piles of people involved in getting them done. I just wish more attention was spent on making sure that integration is done properly to help produce the desired results.

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