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Middle Market Acquisitions: If I Had Only Known©

Anticipating and Reacting to Post-closing Surprises in Middle Market Acquisitions

surprise | sə(r)'prīz |
noun

1 an unexpected or astonishing event, fact, or thing: the announcement was a complete surprise.

- a feeling of mild astonishment or shock caused by something unexpected: much to her surprise, she'd missed him.
- *as modifier* denoting something made, done, or happening unexpectedly: a surprise attack.

March 2015

Joseph Feldman, President
Joseph Feldman Associates
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"Great strategy, planning and integration execution are essential, but not sufficient to ensure success with acquisitions. There will be surprises. Both new and experienced acquirers could benefit from considering the recommendations and experiences offered in this report to be better prepared for the surprises that may surface post-closing."

Thomas Malkoski
Chief Executive Officer
Penford Corporation

"This report offers strategically driven advice for CFOs pursuing the elusive goal of a surprise-free acquisition. From diligence execution through integration planning, it provides actionable recommendations to augment traditional diligence checklists. Especially relevant for middle market companies."

Wendy Katz
former Chief Financial Officer
Talent Partners, LLC

"The report is invaluable reading for CEOs, CFOs and investors contemplating acquisitions. Having been involved in over 150 acquisitions during my career, the report does an excellent job summarizing the many unanticipated risks and providing a blueprint for success."

Dan Gill
Managing Partner
Silver Oak Services Partners

"Acquisitions can be an important part of a middle-market company's growth strategy, but there are traps aplenty for inexperienced acquirers. This report will help you understand the opportunities and avoid the pitfalls."

Thomas A. Stewart
Executive Director
National Center for the Middle Market
Fisher College of Business, Ohio State University

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"If I have seen further, it is by standing on the shoulders of giants"
Sir Isaac Newton

All significant business decisions are subject to uncertainty, and the all-encompassing scope of acquisitions may make such investments among the most uncertain and subject to surprises. Eliminating uncertainty and surprise is, of course, impossible. Anticipating and preparing for what may lie ahead is not.

Over the last several months, I interviewed over eighty middle market executives and advisors who generously shared their stories and observations regarding post-closing surprises following acquisitions. These executives and advisors were asked about the unique challenges for middle market companies growing through acquisitions, focusing on surprises they encountered and learnings that could benefit their peers.

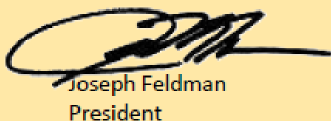
"If I Had Only Known..." is the result.

Their stories and observations provide insights and (I believe) practical advice for middle market executives seeking to grow their businesses through acquisitions. And from my own experience working with middle market companies, I appreciate that urgency and limited resources can create risk for such firms. As such, practical, actionable advice is essential to support effective acquisitions...:

- Each with particular circumstances,
- Each with unique surprises, and
- Each in a long line of companies finding ways to grow through acquisitions.

In closing, I'd like to invite your feedback, whether about this report or about your own experiences with acquisitions surprises. Please contact me at jf@josephfeldman.com. Good luck with your acquisitions!

Sincerely,



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Executive Summary and Recommendations

Post-closing surprises (some good, some bad) occur in all acquisitions. Middle-market companies need special help in anticipating and responding to them, for two reasons. First, their leadership teams are likely to be less experienced in M&A than larger companies, and hence more likely to be surprised and less likely to have experienced similar surprises before. Second, they may have fewer resources than big companies, such as experienced, dedicated post-merger integration teams or armies of outside consultants.

As such, the goal of this study is to fill this knowledge gap with peer-to-peer learning, focused particularly on anticipating and preparing for post-closing surprises with middle market acquisitions.

The executives and advisors interviewed for this report identified a wide range of post-closing surprises, many within the acquired business and others related to deal process itself (see table below). Often, surprises were encountered in multiple areas; after all, acquisitions are among the most complex initiatives that companies may pursue.

Surprises in the Business (pages 6 – 11)	Surprises from the Deal Process (pages 12 – 13)
• Talent and organizational surprises • Customer, product, and market surprises • Operational, systems, and process surprises	• Fraud, non-disclosure and lack of cooperation • Constraints on due diligence

While no two acquisitions or middle market companies are identical, the varied experiences of others may provide invaluable analogies or perhaps even acquisition process suggestions that increase the likelihood of acquisition success. Below are summary recommendations that emerge from the stories and learnings shared in this study; these are discussed more fully in the report on pages 4, 5, and 14 – 16.

- ➔ Organize due diligence against surprise risks, not simply to confirm “facts/figures”
- ➔ Use scenario planning to identify execution and surprise risks
- ➔ Avoid underestimating time requirements of acquisitions
- ➔ Be careful with Year 1 projections
- ➔ Presume organizational surprises
- ➔ Apply multiple strategies to manage risk of surprises
- ➔ Start integration planning early... very early

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Recommendation: Surprise-driven Due Diligence Planning

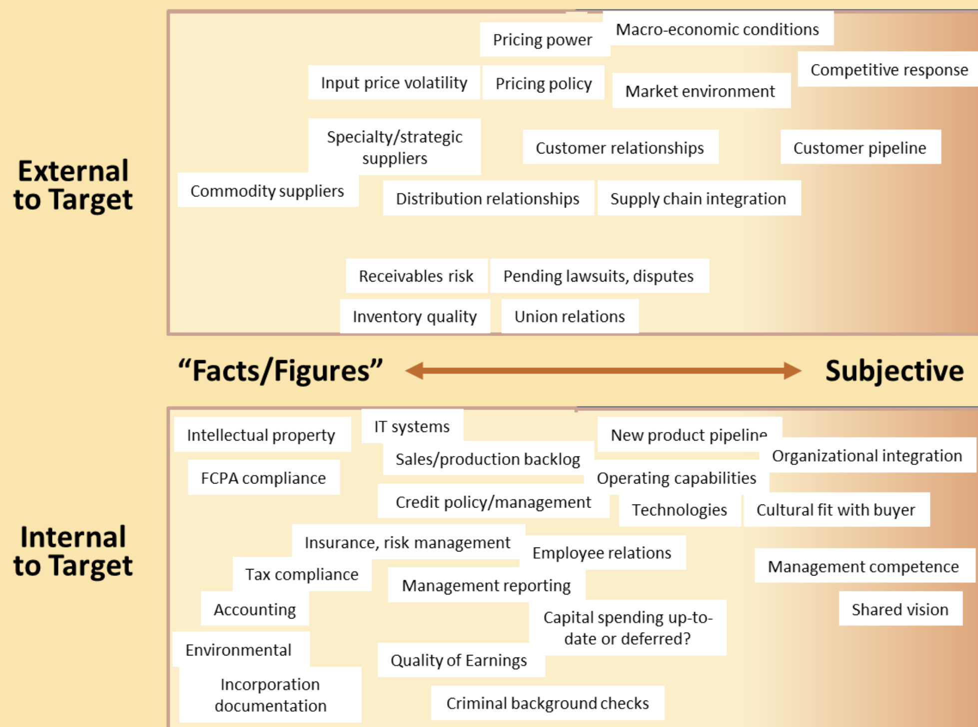
The primary action against surprises is "due diligence", the scope of which should be broadly considered in light of a wide range of surprises that may be encountered.

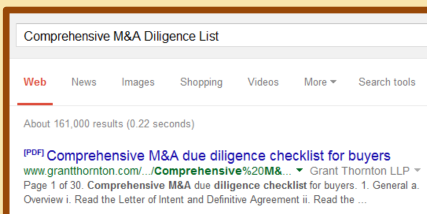
Confirmatory due diligence ≠ Due diligence   Evaluation of potential acquisitions involves a wide range of audits, assessments and analyses that are intended to inform a prospective buyer's consideration of a deal (in total, "due diligence"). These should include any and all aspects of a business, including accounting records, financial performance, key contracts, and tax filings, as well as strategic sourcing relationships, operating capabilities, customer relationships, company leadership, and competitive response, among many other areas.

The more subjective of these areas are inherently more challenging to assess, though very often these are more central to the anticipated value of the acquisition.

Some of these might be described as "facts and figures"; others are far more subjective; a selection of these business topics is shown on the continuum in Figure 1 below.

Figure 1. **The Wide, Wide World of Acquisition Diligence**





Beware of checklists! The "facts/figures" topics shown on the left-hand side of Figure 1 above are typical focus of diligence checklists, often available through lawyers, bankers and other deal resources. Diligence checklists are useful but many business areas of greatest potential for post-

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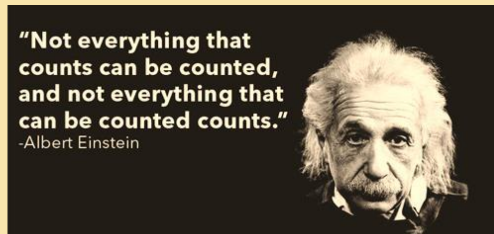
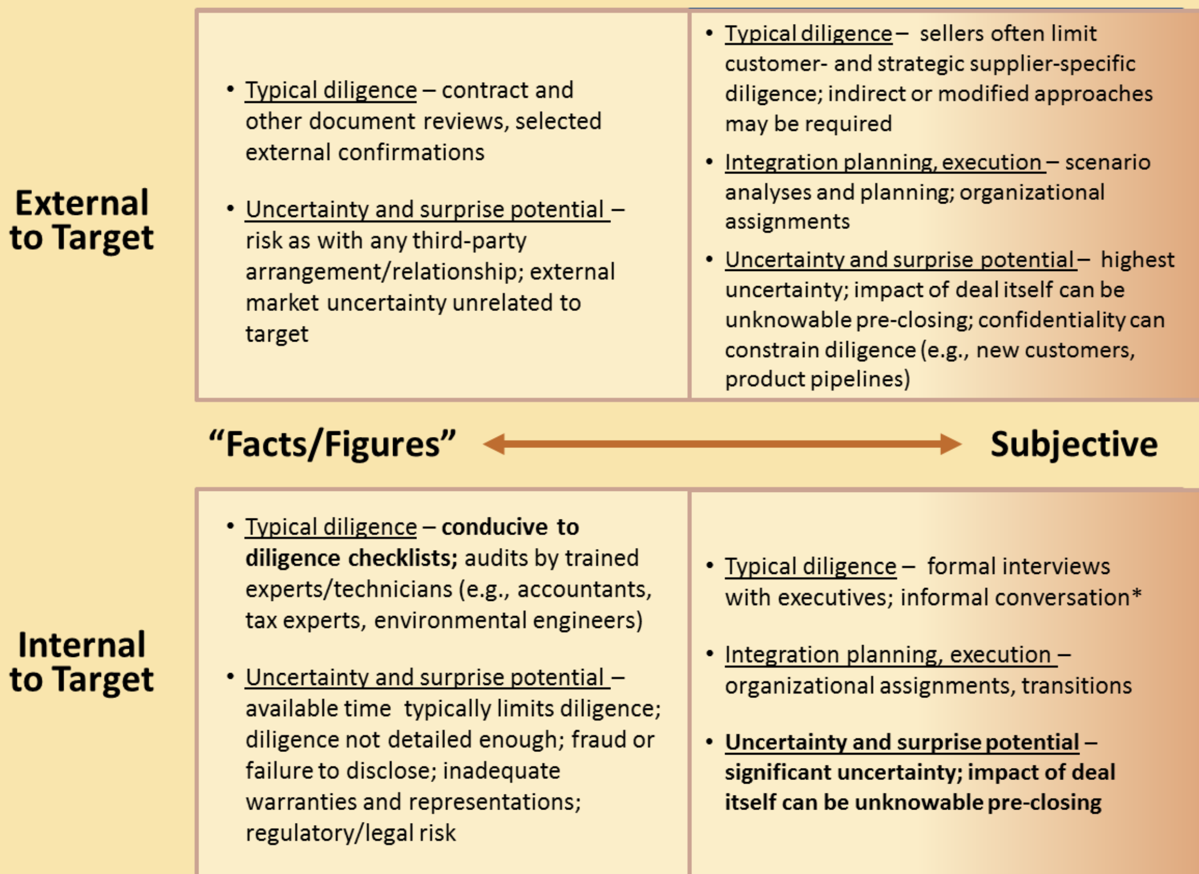
closing surprises aren't conducive to checklists.

One such online resource, jointly developed by the accounting firm Grant Thornton and the law firm Dykema, is the "Comprehensive M&A Diligence List for Buyers". Across thirty pages, this resource comprehensively covers 452 "facts/figures" of potential relevance to an acquirer, though *none of the subjective aspects of a target company*.

The subjective side of diligence... people, customers, relationships The assessment of a business's management team and customer relationships, for example, are by nature subjective with ample room for different, evolving perspectives across different companies or among different executives within an acquirer's team. Moreover, employees and customers have free will; and while financials are financials, an executive can quit and customers can find alternatives.



Acknowledging and employing the wide range of approaches to diligence will increase the likelihood of achieving an acquisition's objectives (see Figure 2 below).



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Reflections from a SVP Human Resources on Delayed Acquisition Integration

A private-equity owned industrial parts distribution company rapidly expanded through the acquisition of over two dozen regional firms. Regional management teams remained in place, operating just as independently post-acquisition as before they were under common ownership.

The lack of integration was unsustainable and the Board of Directors added a Senior Vice President of Human Resources to the management team to develop and implement a go-forward organizational plan.

Joseph Feldman Associates: What prompted the Board to hire you well after the company's acquisition campaign?

SVP, Human Resources, distribution company: The original acquisition plan was focused on quickly adding to the company's national footprint, while purposefully deferring organizational assessments or decisions. In doing so, regional mangers (most former independent owners) ran their businesses as fiefs. There was no coordination of pricing, product lines, or purchasing... and there were no common performance metrics. The financial benefits of accelerating operational integration became increasingly clear to the Board. They were growing impatient and concerned that the status quo might persist as managers across the company settled into not having to really work together.

JFA: Sounds like a complicated situation. Where do you get started?

SVP, HR: The Board and CEO understood that profitability would suffer until all product sourcing and business processes were reasonably consistent across our system. The people side of this "we're all one company" expectation led directly to how the company's executive and management talent needed to be assessed.

JFA: For example?

SVP, HR: For starters, the new, over-riding priority for regional managers was to bring in new customers, while also managing inventory levels, minimizing warehouse theft (a serious problem in our industry), and eliminating on-the-spot discounting to favored customers. Meanwhile vendor selection would be made by corporate, not locally. This turns out to be a very different profile of manager than was typically in place following the acquisition...

JFA: And so that's where your work began?

SVP, HR: Right. Talent assessment ranks among the top challenges for companies making acquisitions. In the best of circumstances, it's difficult to determine whether key managers will be successful in the new organization. And in most acquisitions that I've been involved with, the pre-closing assessments were quite limited.

JFA: What would you do differently?

SVP, HR: Proper assessments of people who aren't yet your employees may be impractical. That said, acquirers should temper their optimism that the target's management will be just fine. Planning for more changes, perhaps many more changes, in the target's team would be sensible in most cases I've worked with.

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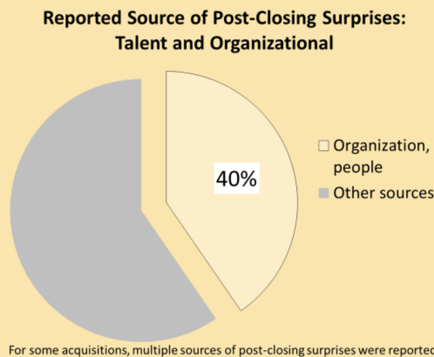
Talent and Organizational Surprises



What they said...

- 40% of respondents identified "organization and people" issues as post-closing surprises for their acquisitions.
- Over 80% of those respondents also indicated that all or most senior management of the target was retained post-closing.
- Nevertheless, only 1/4 of respondents reported lack of success with the acquisition:
  - 59% - rated acquisition successful or very successful
  - 18% - rated acquisition neutral
  - 24% - rated acquisition unsuccessful or very unsuccessful

So what?

- People matter! The most significant reported motivations for the acquisitions are inherently people intensive, i.e., expanding product lines, access new customers and expanding to new geographies.

Recommendations

- ➔ Through an acquisition process, from early engagement and diligence through integration, the importance of competence assessment, cultural differences, and meeting expectations of the acquisition itself are paramount to success.
- ➔ For middle market companies, advance planning and pre-closing diligence must be complemented by careful oversight and flexibility to assure success with the integrating the organizations.

"A better review of personnel prior to the acquisition would have made for a smoother transition. The challenge with this acquisition (or any acquisition) is making difficult decisions on personnel prior to the transaction and managing the planning with the potential risk the deal does not close or the business id disrupted by the acquisition during the diligence phase." Private equity investor Healthcare Industry Company revenue between $50 – 100 million	"Lack of depth of existing management team.... Totally competent in running the business; totally incompetent in doing things differently to grow it." Middle market executive Manufacturing industry Company revenue <$50 million
"At the close of the transaction, we let several employees go. It turned out that a few of them had areas of responsibility that were not identified during diligence, and we were left with a gap that we had to scramble to fill." Middle market executive Healthcare Information Technology Company revenue <$50 million	"... we found out after the acquisition that the management team did not talk to each other. During negotiations they had presented the team as a tight group, and in reality they had very diverse views regarding the future of the company." Private equity investor Company revenue <$50 million

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From the CEO's Desk:
Consumer Products Company Acquisition Surprise

A private-equity owned consumer products company acquired an innovative firm with significant growth prospects in a category of high strategic importance. While the particular product category, key customers, and market trends were well-known to the acquirer, there were nevertheless some post-closing surprises.

Joseph Feldman Associates: What did you learn after the deal closed that surprised you?

CEO, consumer products company: There's always something. Ahead of closing we evaluated [the target's] product line, understood their major customers, and identified several opportunities for both new growth and cost savings. And while we hardly expected things to be fully predictable, we might have better planned for the inevitability of surprises.

JFA: For example?

CEO: For instance, shortly after closing, we suffered an unanticipated distribution loss at a key customer. The possibility of this loss developed during the sale process, though nothing was communicated to us prior to the deal closing. The valuation impact was dramatic, and that loss in revenue simply couldn't be made up within that year.

JFA: Shouldn't due diligence significantly limit surprises like that?

CEO: I have high expectations from due diligence. Some parts of diligence are relatively black-and-white, like whether a manufacturing operation has environmental contaminations. Diligence of certain customer relationships or, say, the fit of a management team, is more a matter of judgment and circumstance. I strongly feel a potential loss in revenue should have been disclosed; although some might say it's simply a risk at the time of the deal. In any case, I'd say it falls in the category of potentially expected surprises.

JFA: What does it look like to "expect" surprises?

CEO: The point is this: we liked [the target's] products, pricing and cost structure, and we identified several ways in which their business might be worth more in our hands. For instance, opportunities to sell into accounts/channels new to them though familiar to us, to expand internationally, to leverage their unique expertise to benefit our existing product lines, and to eliminate redundant headquarters staff. We were comfortable with the core business and that we could deliver on several of these new opportunities... we had confidence of enough opportunities going our way to offset a certain level of surprise for things that went against us.

JFA: And so planning for a surprise seems obvious.

CEO: "20-20 hindsight" is always easy.

JFA: Based on this experience, what would you do differently next time?

CEO: Three things. First, we hadn't adequately tempered the projections for Year One post-closing to account the unknown; doing so would have been prudent vis-à-vis our investors, without needing to ease expectations from our sales team or retained management. Second, for product line acquisitions, the right transition time for our key sales relationships is immediate; individual accounts matter too much to defer integration. And finally, we probably could have bid less and still won the deal. In any case, the acquisition has been financially accretive and strategically successful, though we certainly didn't necessarily follow the script that was in place when the deal was done.

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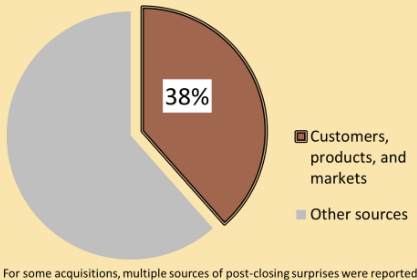
Customer, Product, and Market Surprises



What they said...

- 38% of respondents identified "customer, product, market" issues as post-closing surprises
- Nearly 2/3 of all respondents identified their deal motivation as customer, product, or geographic market related.
- These surprises resulted in the most uneven levels of reported deal success compared with any other type of surprise, including legal/fraud:
  - 35% - rated acquisition successful or very successful
  - 41% - rated acquisition neutral
  - 24% - rated acquisition unsuccessful or very unsuccessful

So what?

- The significance of customer/product/market surprises may be complicated by the limited openness of sellers to providing access to customers during a sale process.
- Often such limitations reflect reasonable sensitivity by a seller to customers seeking negotiating leverage in connection with a sale transaction.

Recommendations

With revenue growth as the predominant deal motivator, capturing a deal's potential value requires a very proactive mindset:

- ➔ Appropriately involve the to-be-responsible sales and marketing executives throughout the acquisition process
- ➔ Start integration planning far ahead of closing
- ➔ Assure timely customer communications, especially upon post-closing

"Customer relationships were not as disclosed. Long history of failed service that led to the loss of two significant contracts within the first 12 months.....

"Seller did not permit us to discuss the relationships with their customers directly so we [contacted] those within the industry that we knew.... No signs led us to believe there were any failed service issues..."

Middle market executive
Transportation industry
Company revenue <$50 million

"The target did not have an understanding of their own customer base."

Middle market executive
Financial services
Company revenue <$50 million

"Acquired company did what they could to keep the acquiring company from talking with customers in detail."

Middle market executive
Home services industry
Company revenue <$50 million

"Acquirer was hasty in discarding carefully crafted sales techniques and culture of target company."

External advisor to management
Travel services
Company revenue between $250 – 500 million

"If our investment these was to improve sales, we could have brought in some sales experts... this step would have been unusual for us, but we should have done it in hindsight."

Private equity investor
Company revenue <$50 million

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From the CEO's Desk: Unpredictable Expectations in Specialty Retailing

A privately owned boutique retailer has expanded from four locations to over twenty through a combination of "greenfield" sites and acquisitions.

Joseph Feldman Associates: How important have acquisitions been to your growth strategy?

CEO: About one-third of our new stores have come through acquisitions. We are known for paying a fair price, treating customers and employees well, and being straightforward throughout the transaction. This approach has made us the acquirer of choice in several situations... it's just good business.

JFA: Where have you run into surprises with the deals you've done?

CEO: We've been fortunate not to have had any disastrous acquisitions. There have been several opportunities we've looked at and then stepped away... perhaps we anticipated surprises waiting for us.

JFA: So far, so lucky.

CEO: Exactly. For the deals we have done, we expect to focus on meeting our standard for in-store service and a customer-driven culture. That's our reputation in the market. Still, we find surprises in the details of how the acquired staff interacts with customers, whether it's handling special orders, scheduling appointments, or resolving the occasional unhappy experience. For our business, these details matter more than can be appreciated, and can prove make-or-break for a particular location.

JFA: Could you share an example?

CEO: Sure. We acquired two locations from a competitor, expecting the suburban location to thrive and the city location to require more attention. We got them completely backwards. We were surprised to learn that the manager at the suburban location was generous with discounts, and had grown a local reputation for taking 10 or 20% off a customer bill for the asking. Eliminating the practice was relatively easy, but the customer base had grown to expect easy discounts and revenue slipped as customers were disappointed and moved away. After the lease expired, we determined that only by transitioning to a new, nearby location could we escape that reputation. Meanwhile, the city location exceeded our expectations for both customer retention and new customers.

JFA: How would you apply this experience to future acquisitions?

CEO: With specialty retail, customers can be fickle... that goes for acquired locations or one we start from scratch. The key is to stay close to the operation, monitor customer feedback, and be prepared to quickly make changes.

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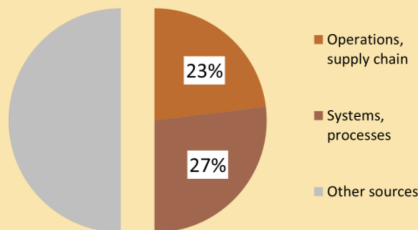
Operational, Systems, and Process Surprises



What they said...

- 50% of respondents identified "operations, systems, supply chain and process" issues as post-closing surprises for their acquisitions
- The most commonly cited surprise related to systems integration, including related to:
  - Legacy systems
  - Systems nomenclature, mapping, related integration implications
  - IT integration experience and competencies

So what?

- When respondents identified their primary deal motivation as related to capacity and sourcing, few operational surprises were reported.
- For the 90% motivated primarily by new products, customers, geographies, or technologies, operational/systems surprises may have resulted from inadequate diligence and integration planning

Recommendations

- ➔ Appropriately involve the to-be-responsible operating and IT executives throughout the acquisition process
- ➔ Start integration planning far ahead of closing
- ➔ Based on the acquisition integration experience of the acquirer's team, pace the operational and systems integration to balance urgency with "do no harm".

"Our company did not have the infrastructure or personnel capable of planning and implementing an integration of the two companies. The lack of expertise resulted in issues with integration of systems and processes...." Middle market executive Food ingredient industry Company revenue <$50 million	"Discovered that CMU (cumulative markup) was not being calculated properly. It was a surprise to all parties. The error was hidden ... and discovered during systems integration." Acquisition integration advisor Retailing Company revenue <$50 million
"Lack of integration of systems from targets previous acquisition, undisclosed poor performers at senior level and under-estimate of required costs to run." Advisor to management Commercial services Company revenue <$50 million	"Before the acquisition target expanded into larger scale projects. The capabilities and supply chain was inadequate resulting insignificant underperformance." Middle market executive IT services industry Company revenue <$50 million
"Supply chain was not diversified or flexible. No channel strategy." Middle market executive Information technology products Company revenue between $250 – 500 million	Process had issues with food safety that required substantial investment to correct. Middle market executive Food ingredients industry Company revenue <$50 million
"IT systems not compatible." Middle market executive Consumer packaged goods industry Company revenue <$50 million	"Company was more vertically integrated than expected." Middle market executive Aerospace industry Company revenue <$50 million

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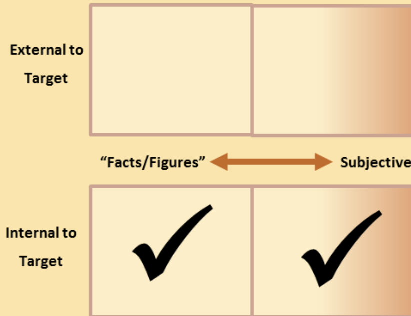
Fraud, Non-disclosure, and Lack of Cooperation



What they said...

- Several respondents identified lack of transparency or cooperation during the diligence process, indicating surprise, for example, with the "...extent to which the former owner and CEO was not as transparent as he should have been."
- Only one respondent to the survey explicitly identified an instance of fraud, specifically related to environmental liability.

So what?

- Ahead of a deal closing, it is expected that a seller would seek to limit disclosures and be disinclined to proactively provide information to prospective buyers.
- Still, an overly uncooperative attitude may merit more concern, particularly when management will be retained post-closing

Recommendations

- ➔ Certain purchase agreement provisions may be helpful here (e.g., disclosure schedules, indemnifications).
- ➔ The interactions requesting access to management or business document disclosure may prove informative of sensitive operational, valuation areas, and of course potential post-closing surprises.
- ➔ Lack of cooperation (and the like) may signal more than simply a negotiating position; opportunities for management assessments are plentiful in an acquisition process for attentive buyers and integration planners.

"....Accounting firm used by the private equity firm should have been more vocal in identifying their concerns over lack of cooperation and availability of information."

"Senior leadership within the acquiring company was ignored by the [sellers] when communicating that critical data was not provided to do the proper due diligence."

Middle market executive
Home services industry
Company revenue <$50 million

"...obtaining data was difficult. Many requests were unavailable."

Middle market executive
IT services
Company revenue <$50 million

"Capabilities of company were greatly exaggerated during due diligence and early stage of the business prevented acquiring company from being able to test various assumptions"

Private equity investor
Company revenue <$50 million

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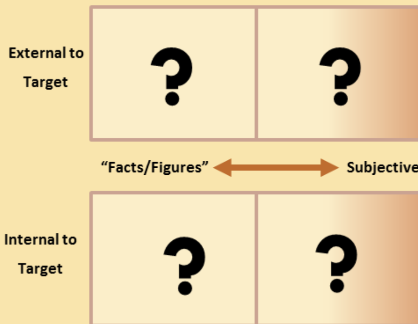
How Much Due Diligence Actually Gets Done?



What they said…

- The feedback from one deal advisor represented many, commenting, ""Management [should have] ignored advice from the Board to 'save costs' and [believe] 'they were adequately knowledgeable.'"
- The relevance and potential value of a more expansive, and necessarily more expensive team was reflected in these comments:
  - "Company relied on internal staff deal advisor only."
  - "Need to use process and performance experts more"

So what?

- Pre-closing diligence and preparation will inevitably be constrained by limited time and money to be invested by a potential buyer investigating an acquisition.
- And the seller (and their bankers or other advisers) may constrain access to documents, leadership, and key external relationships, particularly in an auction or other competitive scenario.

Recommendations

- ➔ Certain purchase agreement provisions may be helpful here (e.g., disclosure schedules, indemnifications), notably so with creating a legal safety net for areas where explicit diligence may not have been undertaken.
- ➔ Prioritization of the diligence campaign is fundamental to the deal and should be managed as such; it directly informs strategic fit, valuation, integration planning/risk, and legal obligations.

"Sometimes acquirers assume smaller targets are less risky. For example, the target may only have reviewed financial statements and not audited."

"A deeper understanding of target business process would have helped. One of the biggest mistakes acquirers make is they get emotionally attached to making the acquisition and lose patience during the due diligence process."

"Day 1 of closing is one of the most important days in the acquisition process. Strategy, organization structure, and staff expectations should be communicated at this time through town hall type meetings."

Middle market executive
IT services
Company revenue <$50 million

"Greater due diligence of non-legal and non-financial issues would have helped. Illusion of urgency seemed to justify the approach."

Advisor to management
Business services
Company revenue between $50 and $100 million

"More rigor would have helped. The acquirer was so enamored with owning new company they looked for the 'best' in scenarios."

Middle market executive
Housewares industry
Company revenue <$50 million

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Recommendation: Utilize Available Risk Management Strategies for Post-closing Surprises

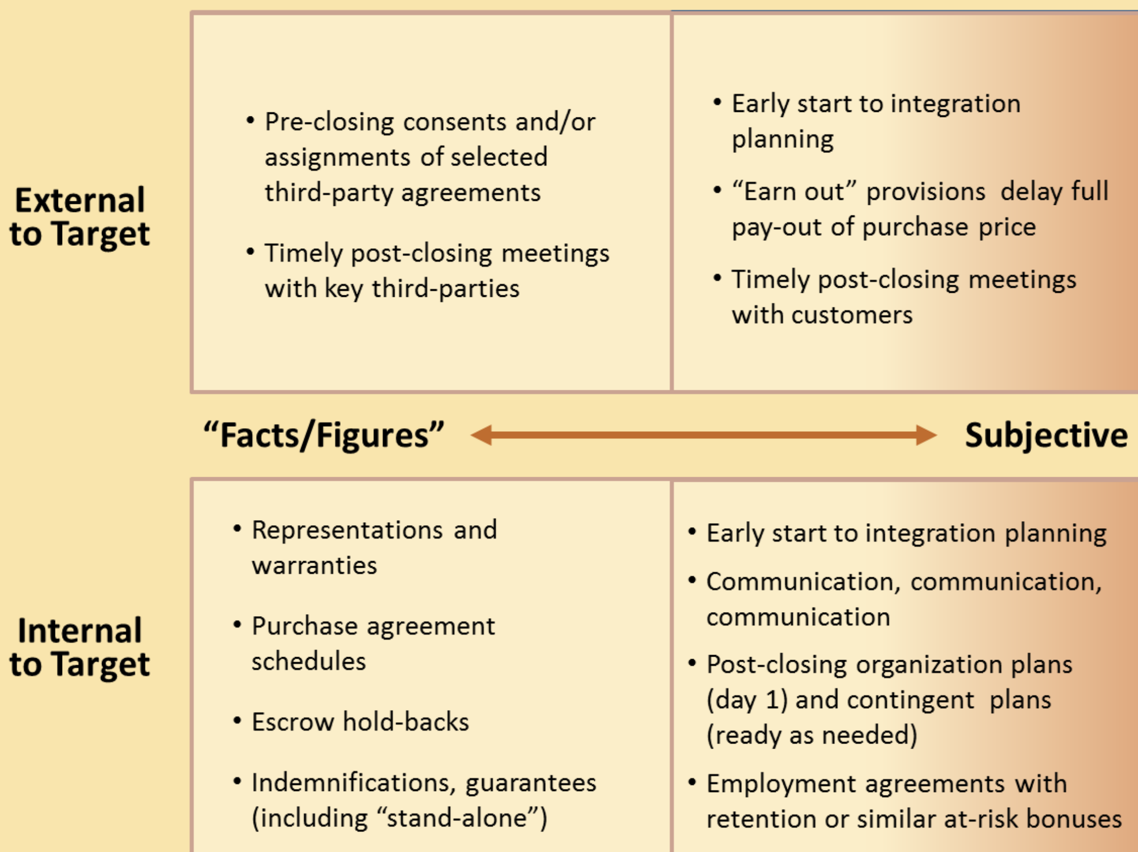
An acquisitions attorney recalled a frustrated call from his client following the completion of an acquisition, and hearing the question regarding a particular operational surprise: "Why didn't you think of that?"

Indeed, certain post-closing surprises may be satisfactorily managed through purchase agreements provisions, such as representations and warranties, escrows, and specified disclosures. Using the framework described earlier in Figures 1 and 2, these legal tools for risk management are indeed well-suited to the "facts/figures" areas of diligence (see left side of Figure 3 below).

Managing the risk of more subjective surprises, such as related to customers and organization, requires different strategies, such as early integration planning or "earn-out" provisions, as summarized below (see right side of Figure 3 below).

When time and resources are limited, including during competitive sale processes, anticipating any and all possible surprises is unlikely, perhaps impossible. However, a wide range of approaches is available and learning from the experiences of others can mitigate the risk that surprises overwhelm the deal's potential.

Figure 3. **Managing the Risk of Surprises**



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Recommendations: Diligence Planning

➔ Use scenario planning to identify execution and surprise risks – Scenario analyses are typically used to develop valuations for acquisitions, though examining a range of potential outcomes can be valuable from an operational and organizational perspective, too.

Considering the financial variability of different scenarios can be complemented with alternative ways that customers, key suppliers and the integrated organization might perform. Doing so can productively moderate the level of optimism and identify areas where some margin for error and planning is appropriate.

➔ Avoid underestimating time requirements of acquisitions - Acquisitions are extremely time-consuming and the day-to-day demands of the base business will not wait. Any significant acquisition will require trade-offs and re-prioritization for a company's management team. There may be opportunities for some external resources (e.g., consultants), though of course the "buck stops" with management for dealing with ongoing and acquisition-related planning and work.

Recommendations: Immediately After Closing...

➔ Be careful with Year One projections – Acquisition valuations require thoughtful financial projections, and the "Year One" projections face particular risks:

a) seller's projections may be overly optimistic,

b) the timing of a business sale may reflect new market developments with impacts not observable pre-closing

c) organizational transition may impact results,

d) anticipated synergies may be realized over time, perhaps far beyond Year One

e) anxious customers may be vulnerable to a competitor or otherwise impacted in unpredicted ways, and

f) strategic supplier relationships may also be unexpectedly affected by the transaction. And finally, the "Year One" projections will be highly scrutinized by investors and an early sign of the deal's potential, so appropriate care is prudent.

➔ Presume organizational surprises – Acquiring a business, its customers and management team often reflects confidence that the company's management has indeed done something well and therefore represents future value to the acquirer. Nevertheless, organizational "surprises" should be presumed, with appropriate back-up plans at the ready. As such, be prepared.

a) New ownership likely brings new expectations, a different culture, an accelerated plan for growth, or simply different priorities;

b) Key talent may leave; and

c) Management suited to a company's entrepreneurial phase may be ill-suited to managing at a larger, faster-paced scale.

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Recommendation: Integration Planning... Can't Start Too Soon

Getting an early start with integration planning may be helpful in reducing the risk of surprises and/or better preparing a company to face surprises encountered. This "early start" may include, for example:

- Involving sales, marketing, and operations executives in pre-closing activities, such as: acquisition strategy development, analysis of potential targets, due diligence, and valuation.
- Designating the executive who will lead integration well ahead of closing, that is, someone who will own the delivery of value from the transaction.
- Using scenarios analyses during the valuation process to identify "what if" possibilities that might be considered for surprise potential from an execution perspective, beyond just the calculation of projected financials.
- Identify possible organizational changes post-closing, and
- Proactively develop communication plans to minimize on-the-fly execution when organizational uncertainty and anxiety may be greatest.

Excerpt from "Middle Market Acquisitions: What's So Hard" (published 2012)
(full report available at www.josephfeldman.com):

Merger integration

Challenge rating*:	
Company executives 4.2 **Advisors** 4.0 5 = Very difficult 1 = Very easy	"Unless the middle market company has integrated companies previously, this is one of the most difficult steps. It is also typically when the company's external advisors have stepped out of the mix. Bringing in experienced integration support would make great sense." *Middle market executive*
Merger "integration" is when the potential of an acquisition is realized, or not. By a significant margin, integration received the highest challenge ratings from company executives, investment bankers, lawyers, accountants, *and* private equity investors. Common recommendations highlighted: (a) the importance of integration planning at the very beginning of an acquisition process, (b) the risk of mis-placed optimism and overconfidence in managing integration, and (c) the benefit of designating a single executive for leadership of integration activities.	82% rated the challenge of integration as either "very challenging" or "challenging."

*Challenge rating is average based on 70+ executives and advisors responding to online survey

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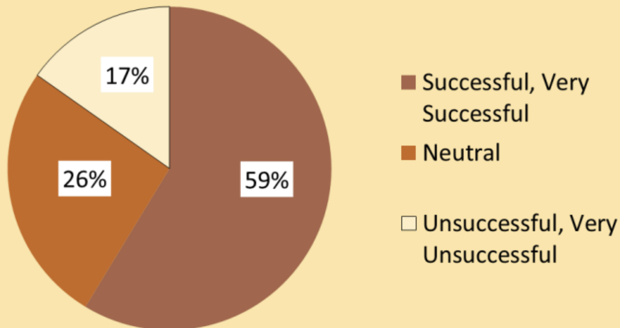
Looking Back...



The eighty-plus executives, investors, and advisors who participated in this study described a wide range of post-closing surprises. And in the end, only about 1 in 6 assessed the acquisition as unsuccessful.

While drawing statistically-based conclusions is hardly appropriate, the contributors to this study suggest that post-closing surprises are generally manageable, should be anticipated, and need not stand in the way of realizing the strategic benefits identified for the acquisition.

As one middle market CEO reflected: "...the acquisition has been financially and strategically successful, though we certainly didn't follow the script that was in place when the deal was done."

"It put us in a market we were not in with some new customers that had business in areas we were servicing elsewhere in the country. Once in the new market, we were able to negotiate new lanes, within the new market, with some of our existing major accounts and increase our revenue base relatively quickly." Middle market executive Transportation Company revenue <$50 million	"The acquisition, although moving slower than expected and with less investment than expected, positioned the acquiring company ahead of its competitors in this important new area." Advisor to management Gas/oil services Company revenue<$50 million
"Acquirer received synergistic benefits to its existing sales to its own customers. Even though target company sales declined significantly, acquirer's overall business has benefited." Advisor to management Travel services Company revenues between $250 - $500 million	"The surprise ended up being a one-time blip that was corrected. Became part of the 'acquisition cost'". Advisor to management Travel services Company revenues between $250 - $500 million
"We caught this early. We are still working through it." Private equity investor Company revenue <$50 million	

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Study methodology

- The survey for this study was posted on Survey Monkey® from June through November 2014. Below are the questions related to the source of the post-closing “surprise” as shown on Survey Monkey. The 20-question survey prompted for demographic information, as well as background regarding the source of the acquisition, any post-closing surprises, pre-closing red flags, and assessment of the overall success of the deal.

"If I Had Only Known..."

There are a wide range of post-purchase "surprises" that may prompt an acquirer to think "If I had only known..." then the outcome from this acquisition might have been quite different. For the following questions, please consider the most significant "surprise" encountered with this acquisition.

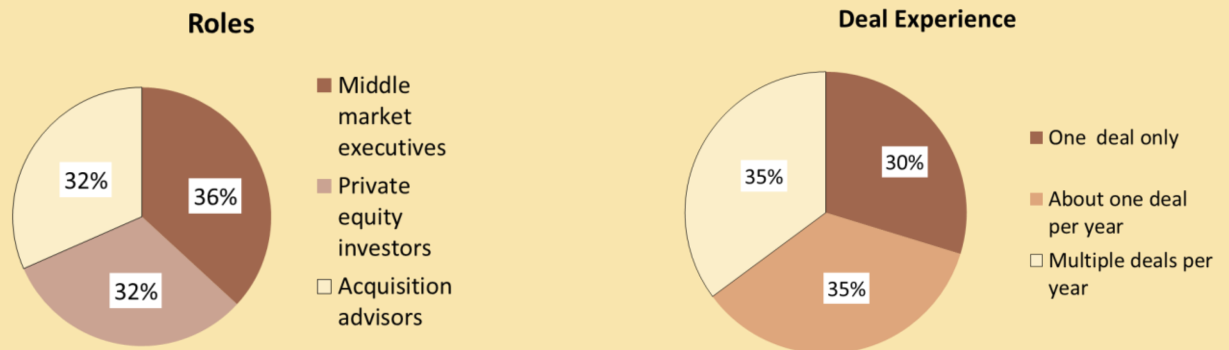
7. Which of the following best describes the type of "surprise" that was encountered in this acquisition? (Select all that apply)

- ☐ Issue related to customers, products, and markets
- ☐ Competitive response
- ☐ Issue related to operations, supply chain
- ☐ Issue related to organization, people
- ☐ Issue related to integration of company systems, processes
- ☐ Issue related to legal or liability
- ☐ No surprises were encountered

Other (please specify)

8. Please describe the "surprise" encountered in this acquisition

- Respondents represented a diversity of acquisition roles, experience, and industries, as shown below:



Industries represented

Aerospace	Healthcare IT
Business services	IT products
Consumer products	Medical Device
Event Management	Pharmaceuticals
Financial Services	Retail
Food Ingredients	Services
Food processing equipment	System integrator and security
Gas/Oil Services	Technology, media
Healthcare	Transportation

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“Middle market” definition

There is broad acknowledgement that the definition of “middle market” varies depending on who’s offering a point of view. That said, this report is likely most relevant for companies with revenues in the range of $25 million on the low side and $1 billion on the high side.

With appreciation

The following individuals provided invaluable advice and support for the project, for which I am grateful: Jill Albrinck, Jason Apple, Mike Barzyk, Tom Goldblatt, Wendy Katz, Kison Patel, Liz Robinson, JP Ruiz-Funes, Stan Stec, Tom Stewart, and Dylan Whitcher. In addition, I’m grateful for the three interviewees who shared their stories and insight... and who wish to remain anonymous.

Finally, special thanks to the eighty-plus individuals who contributed their time and shared their expertise through participation in the survey. They have enabled this report and the opportunity to benefit from their experience.

About Joseph Feldman Associates

Joseph Feldman Associates provides acquisition and other strategic transaction consulting for growing companies and their investors:

- We combine "large company" know-how and discipline with "start-up company" practicality, resourcefulness, and urgency.
- We deliver timely and effective results for our clients

Project scope may include all or some of the following activities, determined on a case-by-case basis to meet client requirements:

Acquisition Project Management

- Strategy development
- Deal flow generation
- Outreach to targets, bankers, and other resources supporting potential deals
- Development of internal and external presentations

Target-specific Work:

- Evaluation of strategic fit
- Contacts with targets
- Deal valuation
- Due diligence
- Negotiation support
- Documentation and closure
- Integration planning

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