VIDEO ROUNDTABLE DISCUSSION
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BUILDING PE PORTFOLIOS THROUGH BOLT-ONS
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Facted with historically high acquisition multiples, increasingly stiff competition from corporate investors and a financial environment awash in money, private equity firms are turning more and more to smaller, add-on assets to shape their investments. A panel of PE experts explored that theme during a recent roundtable discussion, “Building PE portfolios through bolt-ons.” The Deal and online deal-sourcing platform Intralinks Dealnexus co-produced the Webcast.

Panelists included Jim Andersen, co-founder and managing director of Clearview Capital LLC; Richard Prestegaard, partner, business development at High Road Capital; and Robert Landis, partner, origination, at The Riverside Company; and Tony Hill, a director at Intralinks Dealnexus, served as moderator.

“Multiples have been perhaps the highest they’ve been in my career,” said Landis, a veteran PE professional with almost 40 years experience. “The only way that you can achieve a good return on your investments is to do bolt-ons at a lower multiple.”

According to Landis, an “average company” now sells for more than 10 times Ebitda. His firm scours the landscape looking for smaller companies Riverside can integrate with its larger, platform companies. These smaller targets go for 5 to 7 times Ebitda. They “are not quite as pretty, have huge gaps in their management or huge gaps in their sales organization,” he said, “but they have a great product, or a great service, that fits perfectly” with an existing holding.

In 2014, Riverside acquired 40 companies, 20 of which were add-ons. The focus on add-on acquisitions transcends individual sectors. “We’ve seen it right across the board,” Landis said.

It is gaining traction not only with PE firms, but with their limited partners, institutions investing in private equity. According to Landis, limited partners are now peppering their PE firms about a strategy for bolt-ons.

Last year, bolt-on investments globally totaled about $50 billion spread over more than 1,100 transactions, according to statistics cited by Hill. That’s the biggest total since M&A’s glory days of 2006. Of those, 738 were in the U.S., totaling $25.8 billion, he said.

Acquiring add-ons drives down the overall multiple of the expanded platform, Andersen explained. For Clearview, he said, there are “typically three to five” add-ons for each platform company. But his firm has combined in one platform, Senior Care Centers of America Co., with 14 bolt-ons. “Essentially all of our targets did exactly what we did,” he said. “They were adult daycare centers, so we knew exactly how to operate them, and they were very easy to fold in.”

One positive of smaller bolt-ons is their ability to hedge financial bets. “You take a lot more risk when you do a big add-on acquisition because, if you’re wrong, you’re dead—but if you’re wrong on a small one, you can recover,” Andersen said.

Another advantage of pursuing add-ons is a lack of competition from corporate acquirers. “The smaller deals … I don’t see the strategics,” Landis said.

There’s a threshold, Prestegaard added. “They tend to be at more of the higher end of our scale, so 7 million of Ebitda and higher [is] when we see a strategic come in.”

One problem with competing with strategic investors is their lack of predictability, Andersen said. With strategics, “you never know how they’re going to value something. They may have some reason why they can pay literally $100 million more than the next guy and be happy about it.”

However, Andersen said that with stiff competition for bigger targets, he’s seeing the large private equity firms move down the acquisition trail and do smaller deals they haven’t traditionally shown interest in. That, Andersen said, can bump up valuations. “They’re accustomed to paying higher multiples,” he said.

With smaller acquisitions come other issues, panelists said. One of the biggest is management integration. “What’s happening with the management team? Are they staying? Are they going?” Prestegaard asked. “How the management team fits is one of the strongest considerations that we have to have when we’re looking at add-ons.”

Landis cited the example of potential add-ons to one of his firm’s platform companies, which had excess capacity. Some managers didn’t want to uproot employees and shift them to the platform facility to increase production efficiency, which complicated the deal.

Management integration extends to employees. The key is communication, Landis said. “The worst that could happen is that you don’t provide the right information, people get nervous and people vote with their feet,” he said. “Typically, the people who vote with their feet are the best ones.”

An ideal situation, he explained, is when the owner says he’s selling and retiring. “You go ‘yahoo!’ because you don’t have to worry about that management integration.”

When things fall down, it’s typically about people,” Andersen concluded.

Another issue is technology. With smaller companies, for example, financial management may be lacking. The key, Andersen said, is to have a strong IT backbone where acquired systems can be grabbed and plugged in as easily as possible.

The ability to adequately source potential deals was the subject of spirited discussion as well. More and more PE
firms will have dedicated deal-sourcing teams, Prestegaard believes. “I don’t see how it’s going to stop. It makes too much sense,” he said.

Meanwhile, the firms continue to rely on third parties such as investment bankers personal relationships, both within a particular industry and with advisors remain critical, the panelists stressed.

Even with added in-house firepower such as origination teams, panelists agreed, firms need a variety of sophisticated tools to source and manage potential deals. This includes both database and customer relationship management technology and online platforms such as Dealnexus.

“That’s something that helps make everyone else more efficient,” said Prestegaard. While Prestegaard termed online platforms “at minimum a safety net and in a very positive, a potential source of new platforms,” they are especially beneficial for add-ons, he believes. Firms such as his can create a profile of platform companies and find potential bolt-on targets that match in terms of desired characteristics and with attributes complementary to the platform. “That should help you see a lot more opportunities for add-ons especially,” Prestegaard said.

Each panelist gave one example of a platform company owned in search of bolt-ons. For Andersen’s Clearview, it’s Northwest Cosmetics, a manufacturer of formulations primarily for liquid cosmetics. It’s now looking for add-ons that expand product capabilities, like powder. It’s also looking to have a larger presence on the east coast to balance its West Coast base.

High Road owns York Wallcoverings, a Pennsylvania-based company that distributes wallpaper, moldings and related products. “They’ve got a great distribution network,” Prestegaard said, adding that it should work “beyond wallcovering type products, so we’re casting a sort of broad net right now and considering lots of different product categories.”

Lastly, Landis described a Riverside-owned company called Greenphire, just acquired in December. Greenphire provides clinical trial payment technology for the healthcare industry. Much of that clinical trial work is done overseas so Greenphire is attempting to expand outside the U.S.

For private equity, the most important number is how much can be realized when investments are sold. That’s the heart of an add-on policy, the panelists said. “At the end of the day, are you building a bigger and qualitatively better company,” Prestegaard asked. “You don’t really know that until exit, but you should be doing the add-on because you are generating a better IRR [internal rate of return], you’re going to generate a better exit multiple.”

Historical data supports the acquisition of add-ons, and sooner rather than later. Riverside looked at its investments historically since its founding in 1988, Landis said. “We found that for every company that we did an add-on within the first year of acquisition, we got one to one-and-a-half times Ebitda more for those companies than those which we didn’t do add-ons that first year but it came a little bit later.”

While panelists agreed on the benefit of add-ons, they said they don’t submit as many bids these days on companies, big or small, because multiples are so high. “Even a small company thinks it’s worth 10 times” Ebitda, according to Andersen. So, he explained, his firm has passed on a number of attractive companies “where we just thought there’s no point because it’s going to go for a multiple higher than we’ll want to pay for it.”

Private equity must still work through a huge universe of potential acquisitions.

Landis revealed these statistics: His firm last year “looked at” 4,200 companies globally and reviewed 792. That resulted in 40 acquisitions.

Deal flow overall remains robust. Landis said he was especially surprised to see pitches start just after the beginning of the year. “Usually in January and February, we’re picking up our phone to see if it works,” he quipped. This year, “it was starting to ring around 10 January.”