Recipe for a Roll-Up

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Entrepreneurs in the middle market are often approached by private equity firms or strategic buyers with attractive offers to acquire their businesses. Many of these buyers are conducting the transaction as part of a roll-up strategy. In recent years, the middle market has been rife with roll-up activity, and this trend is likely to continue. In an economic environment where rates are most likely to decrease, we expect more activity and greater opportunities for founders to exit their businesses.

In this article, we will explore the nature of roll-ups and what drives them. From the perspective of the entrepreneur, we will highlight the industries that are attractive roll-up candidates. Founders and business owners who operate within these sectors should prepare for the proverbial knock on the door with an offer that they will seriously entertain.

Recipe for a Roll-up

The classic definition of a roll-up is when the acquirer uses mergers and acquisitions to combine multiple small companies into a larger entity that is better positioned to enjoy economies of scale. The goals of a roll-up strategy can include acquiring customers or expanding product offerings. Consolidators may pursue roll-ups for customer acquisition, particularly when sales cycles in an existing market are costly and lengthy. Additionally, a roll-up strategy can be driven by the desire to expand into adjacent verticals or new geographic regions.

The main ingredients of a roll-up include:

- Large but highly fragmented industries that are lacking a dominant player.
- Consolidators with a proven process that creates value.
- A structured approach to identifying, evaluating, and integrating target companies.

The Savory Appeal of Roll-Ups

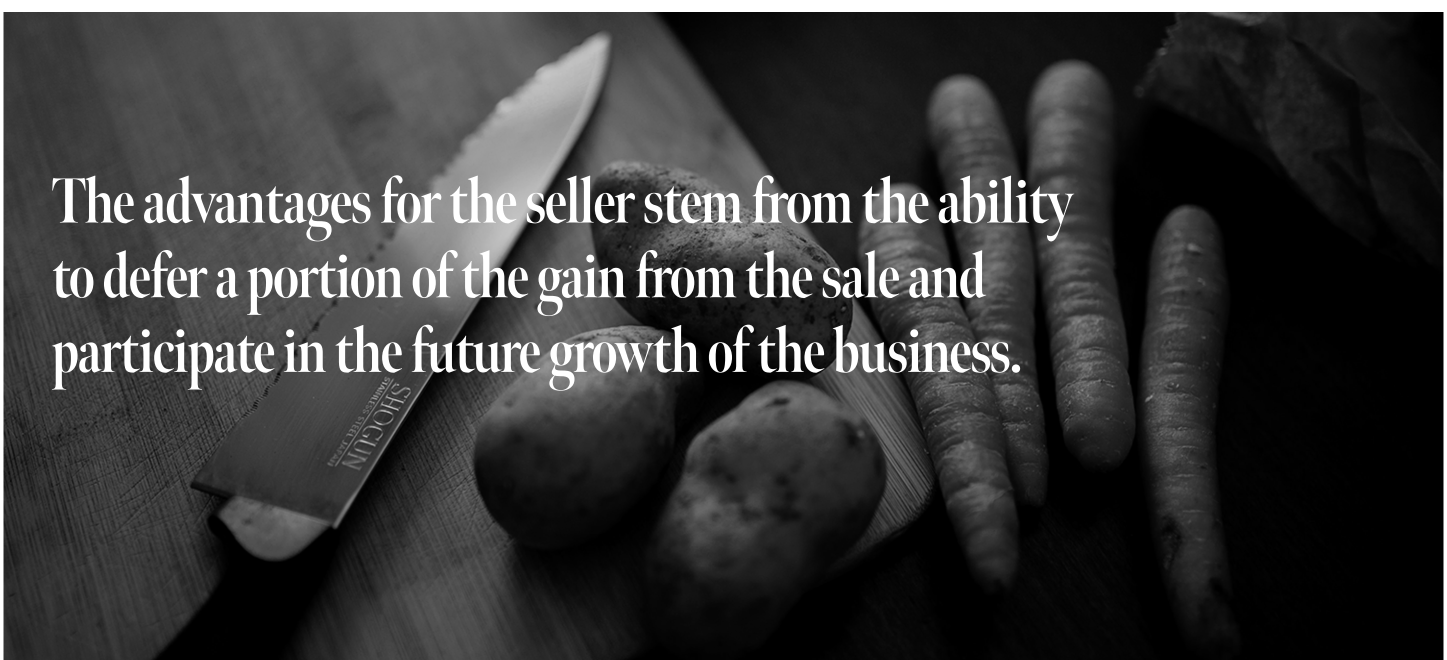
The most common proponents of roll-up strategies are private equity firms. With private equity firms, it is quite common for the founder to be required to invest a portion of the sales proceeds into the consolidating entity that is executing the roll-up. Founders are required to invest 20-30%, on average, of the purchase price in the roll-up entity. The advantages for the seller stem from the ability to defer a portion of the gain from the sale and participate in the future growth of the business. In this scenario, the private equity/strategic buyer often acts as a consolidator with a plan to acquire several businesses of similar size within the same industry. To the seller's advantage, they can gain a second bite at the apple if the roll-up entity ends up being acquired by yet another private equity or strategic buyer.

Additionally, here are some of the key advantages of a roll-up:

- An industry roll-up allows the buyer to achieve significant and rapid growth, potentially profitable expansion across markets, and the creation of a larger market presence in a relatively short time.
- Consolidating back-office functions of the acquired companies can achieve economies of scale, growing the aggregate revenue stream without a corresponding increase in overhead.
- An opportunity to fast-track revenue growth, earnings, and generate multiple expansion.

Measuring Success in Roll-Up Strategies

THOROUGH PLANNING	SYSTEMIZATION	GOOD INDUSTRY UNDERSTANDING	EFFECTIVE DUE DILIGENCE
CAREFUL HIRING	CLOSE ATTENTION TO PMI & CHANGE MANAGEMENT		GOOD TIMING



Hot and Ready: Industries That are Ready to Serve in a Roll-up

The following lists industries that are currently attractive to consolidators for roll-ups:

- Rural telecom
- Security services
- Oil and gas
- Landscaping
- Healthcare services
- Distribution
- Cleaning services
- Retail
- Auto body and repair shops
- Commercial roofing
- Plumbing
- HVAC

This list is by no means all-inclusive, but these sectors align with the key ingredients that make them potentially attractive candidates for roll-ups.

Blending Flavors: General Characteristics of Industries Attractive to Consolidators

Fragmentation

- Numerous small players
- Low market share concentration
- Positive growth forecasts
- Owners willing to sell

Consistent Demand

- Steady market needs
- Essential services

Operational Inefficiencies

- Lack of standardization/inefficient operations
- Scalability Potential
- Economies of scale
- Cross-selling opportunities

Financial Stability

- Predictable cash flow
- Low capital expenditure

Customer Base

- Diverse customer base/consumer loyalty

Cooking to Perfection: Key Considerations Before Pursuing a Roll-Up

Entrepreneurs and founders whose companies operate in these targeted industries are positioned to capitalize on this trend and should be on the lookout for the knock on the door.

But when deciding whether to accept an attractive offer, a few factors should come into consideration. The financial aspects of the transaction are rightfully given the most attention. Beyond the numbers, however, other concerns and questions need to be resolved before moving forward. The terms and conditions of the transaction can change the way the deal is perceived after closing, so the post-transaction consequences should be top of mind as well.

Role of the Founder: Still the Head Chef?

As a founder of the entity, there are several factors to consider. Will the seller continue to work as part of the management team of the combined entity? This can be a concern because the founder may not be included as part of the senior leadership of the combined entity. Instead, they find themselves working as a “sous chef” under a lengthy employment contract. The transition from being the primary decision-maker to a more limited role can be challenging for someone who was previously “large and in charge.” Be sure to set clear expectations for both you and the buyer in advance.

The Retirement Menu… As Good as it Sounds?

Without careful planning, entrepreneurs who have reached the end of the road and are looking to exit as the next step to retirement may find themselves unable to retire early – or at all. The roll-up entity may require active and intense involvement for it to reach its full potential, making a roll-up less suitable for those planning to sell and step away. In this case, a roll-up may not be the best fit. Many Baby Boomer founders plan to retire by selling their businesses but participating in a roll-up could derail those plans. In the worst cases, the founder might be tied to a lengthy post-sale employment agreement, hindering their ability to fully retire.

What Happens to Key Employees? The Ingredients that May Get Left Out

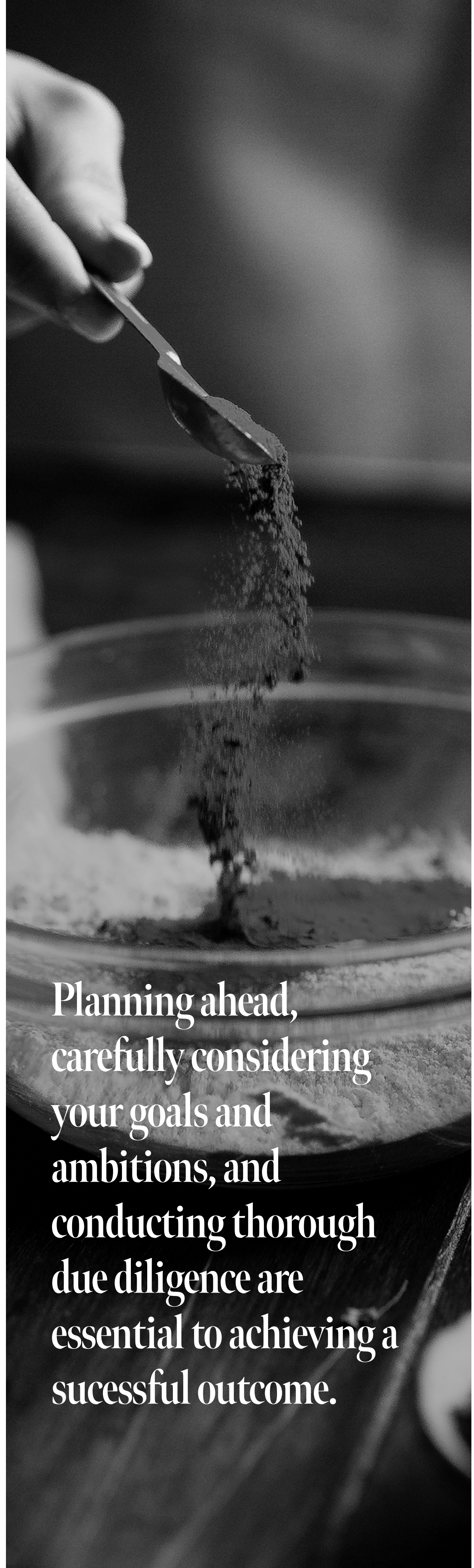
Succession plans may have to be scuttled. The designated successor may not be selected for a meaningful role in the combined entity. The founder may have to accept that the successor or next layer of management who had been promised that they would run the business may not have a role to play going forward. Oftentimes, the roll-up strategy involves streamlining management layers, which may result in the COO, CFO, or other managers being laid off as a result.

These are just a few of the factors that may make selling to a roll-up less attractive. Planning ahead, carefully considering your goals and ambitions, and conducting thorough due diligence are essential to achieving a successful outcome.

As the economic cycle tilts towards lower interest rates, mergers and acquisition activity across the middle market is likely to increase. Founders in certain industries and sectors will find themselves approached to sell and the buyers are often consolidators executing on a roll-up strategy. The goal of the article is to prepare founders when an attractive offer comes along. Knowing what to expect and being prepared can make all the difference between a successful exit and lingering regret over the deal. Consulting with experts can help you navigate the complexities of process and ensure a recipe for success.

Let's talk.

For more information, call **855-949-5855** or email **newedgewealth@newedgecg.com**.



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