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WHITEPAPER

BUY & BUILD SECRETS OF SUCCESS

Lessons Learnt from a Successful Post-Merger Integration

May 2021

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IN PARTNERSHIP WITH

ESDEC INNOVATIVE MOUNTING SYSTEMS

Gilde Buy Out Partners

About Humatica

Humatica helps private equity funds and portfolio company leaders build organizations to deliver alpha. Working with hundreds of portfolio companies for over fifteen years, Humatica has codified the management practices and operating models that drive value creation.

Our unique suite of tool supported services, benchmarks and advanced org analytics enables accelerated implementation of the value growth plan with minimal risk.

Fact-based transparency, coupled with deep leadership experience, enables rapid consensus on pragmatic improvements to activate organizations and deliver alpha.

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ACKNOWLEDGEMENTS

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We would also like to thank Associate Professor Kenneth Younge of the École polytechnique fédérale de Lausanne (EPFL) in Switzerland for his thought leadership and guidance during the project.

And finally, we thank our Humatica consulting team members Andros Payne, Andreas Knobloch and Louis de Guyenro for their contributions to this whitepaper. What began as Louis' master thesis at EPFL, has developed to become a practical guide for private equity professionals and senior executives wanting to successfully implement Buy & Build strategies.

SECTION 1.0

Why Buy & Build?

SECTION 1

WHY BUY & BUILD?

In an increasingly competitive deal market, private equity firms are turning to Buy & Build strategies to realize superior returns on their invested capital.

“Buy & Build” refers to an investment strategy whereby a PE-fund acquires an initial “anchor investment” company, with stable management, a scalable infrastructure and effective sales network as a “platform” with which to add other “bolt-on” acquisitions within the same industry. By skillfully combining the scale and competencies of the acquired firms, with a common strategy, it is possible to accelerate top-line growth and realise cost synergies at the same time – driving rapid margin expansion. Large, fragmented industries, with stable cash flows offer ideal conditions to merge existing players, achieve synergies and increase market power before others have a chance to catch-up. This drives EBITDA multiple expansion on top of margin expansion to deliver explosive value growth.

50% of private equity transactions were Buy & Build in 2018

120% increase in add-on acquisitions from 2013 to 2019

Buy & Build strategies have increased in importance over the last decade. They represented just 28% of private equity deals in 2004. The Financial Times notes that they made-up nearly 50% of private equity transactions in 2018. The number of add-on acquisitions has increased to 719 in 2019, a 120% increase from 2013 (328 add-ons deals) according to Silverfleet Capital’s European Buy & Build 2019 index. Add-on Buy & Build acquisitions have not only increased in quantity, but also in size. Only 20% of all platform deals were $500M+ in 1995-2000 compared to 50% in the 2009-2016 period. Buy & Build has shifted from the small-to-mid-market towards targeting bigger platforms.

Buy & Build’s increasing popularity has its roots in the hard-facts economics of scale. The market pays higher valuation multiples for larger companies with a better risk profile and attractive growth prospects. According to Andros Payne of Humatica, “Increasing market share, while taking out the number of competitors in the industry gives more market power over customers, suppliers and competitors for the merged organization – which is worth the next buyer paying a higher earnings multiple”.

But it is not enough to acquire and let companies run independently on a stand-alone basis. As more than half of private equity deals are secondaries, and investors have become savvy to quick-flips, organisational DD of Buy & Build platforms has become more rigorous. Acquired companies need to be successfully integrated into a well-functioning, merged organization in order to credibly argue a full-priced exit valuation. Andreas Knobloch of Humatica adds, “Buy & Builds need to integrate platforms and add-ons intelligently to create a credible, well-structured new organization that the acquirer can sustainably build on”.

Gilde Buy Out Partners' consolidation of the US solar panel mounting market with the acquisition of EcoFasten, IronRidge, and Quick Mount PV under the Dutch ESDEC brand is an example of best-practice in Buy & Build. According to Gilde Operating Partner Joost Heeremans, "The fast-growing market of advanced mounting systems was still young and fragmented, with many smaller entrepreneurial companies selling to large distributors and installers, creating the need to bring the industry to the next level. We saw a unique opportunity to build the undisputed market leader able to serve its customers better. We saw synergies no one was competing for". Andreas Knobloch, Humatica's project lead for the Buy & Build integration notes that "The target market had no dominant player, was fragmented and growing fast – great conditions for a Buy & Build as the first scaler can reap the benefits".

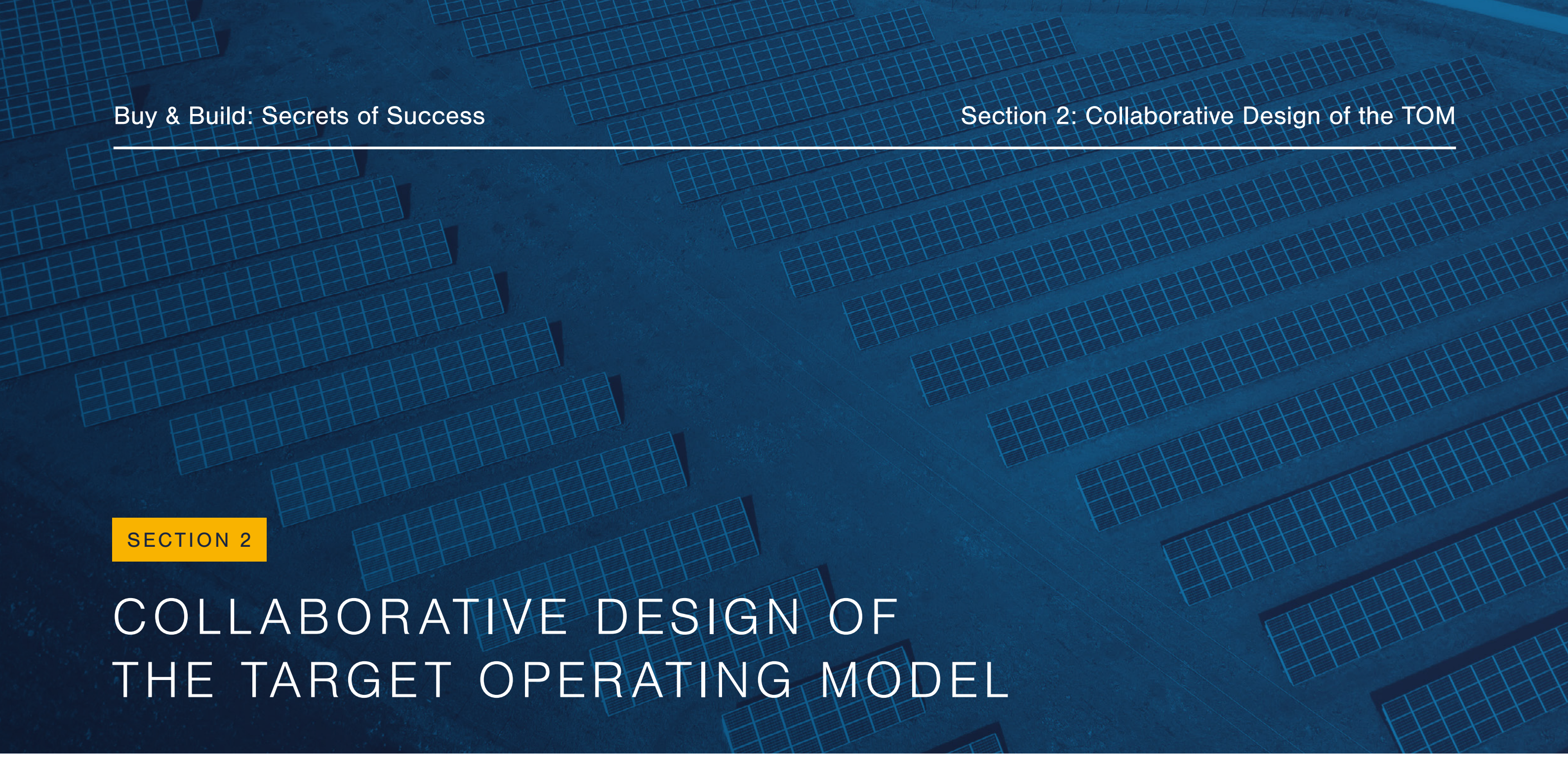
Three key integration success factors distinguish successful Buy & Builds deals from the rest. The merged organization design should have the economically most optimal degree of integration between platform and add-on acquisitions within each function, which takes advantage of scale, but without sacrificing accountability. Second, an atmosphere of collaboration must be established between to-be-merged firms from the beginning to facilitate constructive realization of synergies. And finally, a well-structured governance process and neutral, third-party facilitation is needed to ensure smooth integration and risk mitigation.

> Increasing market share, while taking out the number of competitors in the industry gives more market power over customers, suppliers and competitors for the merged organization – which is worth the next buyer paying a higher earnings multiple.

Andros Payne
Managing Partner & Founder
Humatica

SECTION 2.0

Collaborative Design of the Target Operating Model



SECTION 2

COLLABORATIVE DESIGN OF THE TARGET OPERATING MODEL

Defining a target operating model "TOM" is an essential first step following a bolt-on acquisition. It sets the organizational framework for the future management structure and long-tail of PMI decisions. A TOM is the block-diagram level description of how the merged company should be organized to deliver the value creation plan. It defines the major activity areas and interfaces needed to drive organizational efficiency and effectiveness for execution.

Often, the acquirer will try to define the TOM pre-deal, in isolation, and force it on the target after closing. The problem with this is that acquiring managers don't understand enough about the target, its structures, interfaces, processes, and its management to make good decisions. It's a recipe for disaster.

The optimal TOM will realize scale and experience-curve synergies, while minimizing interface costs, facilitating subsequent acquisitions, and ensuring clear accountabilities. Making the right calls on a set-up that optimizes these economic factors requires the combined experience and business understanding that both management teams collectively bring to the table. It's therefore essential to involve the acquired firm's management in defining the future TOM. However this is often difficult, especially in cases where the companies were previously direct competitors.

Another common concern is that effected managers cannot be involved in defining the future, merged operating model as they will be directly effected and biased based on their self-interest. Conventional wisdom says that integrating N-1 managers into the TOM definition process is risky, and like "inviting turkeys to Thanksgiving". However, this need not be so.

Up-front transparency on each standalone organization gives managers the context for merger decisions and the integration logic. An education process needs to deliver a joint understanding of the other firm's history, culture, strategy, organizational strengths and weaknesses to build trust before discussing the best future set-up.

> Transparency on each of the organizations and collaboration among the management teams were essential for building trust and a fit-for-purpose operating model.

Joost Heeremans
Partner and Program Manager PEP
Gilde Buy Out Partners

Objective, fact-based transparency on each of the to-be-merged organizations is the starting spot for trust building and involving managers from both companies in designing the future operating model. Andros Payne notes, “Objective transparency on each of the organizations is critical for getting the facts on the table up-front and taking the emotions out of the discussion to enable good collaboration. It’s also essential for understanding structural, process and governance trade-offs in the new TOM and avoiding misunderstandings among the management teams”.

Risks are further reduced and time won by engaging an unencumbered, neutral third party facilitator to drive decisions and consensus on the new TOM. First impressions are always difficult to overturn. So it is most important for a high-EQ facilitator to make sure the first meeting of managers from both companies is a good meeting which builds trust and avoids anchoring misunderstandings or suspicions.

It’s also important from a change management perspective to collectively explore various operating model alternatives before getting consensus on the optimum TOM in the face of diverse constraints. Group discussions, based on logic and the merits, rather than off-line side-discussions will up the quality of thinking, and avoid back-room gaming that destroys trust.

Gilde Buy Out Partners acquired IronRidge, EcoFasten and Quick Mount PV, three of the largest US solar panel mounting competitors in quick succession as part of their ESDEC Solar Group international roll-up in 2019. They applied a transparent and collaborative best-practice approach to defining the new TOM. According to Gilde’s Joost Heeremans, “transparency on each of the organizations and collaboration among the management teams were essential for building trust and a fit-for-purpose operating model”.

A well-structured and transparent process involving managers from both companies increases the quality of decisions and buy-in, while lowering implementation risk. But it is essential that it gets off to a good start from the first meeting when first impressions are made.

SECTION 3.0

Merging Sales & Marketing Organisations

SECTION 3

MERGING SALES & MARKETING ORGANISATIONS

Defining what functions should be merged and which should not is a key step in defining the post-merger operating model.

The fundamental economic drivers which guide decisions are:

1. cost reduction through scale effects
2. increased effectiveness of activities with a steep learning (experience) curve
3. efficient interfaces that ensure clear accountability

High-performing Buy & Build roll-ups rapidly integrate non-customer-facing, scale-driven activities like production, procurement, logistics. They also integrate areas with large experience curve benefits such as R&D, Sales & Marketing, After Sales and Customer Support.

In particular with Sales & Marketing, synergy potential needs to be balanced with the required level of autonomy and value of specialization. Too hasty consolidation risks disrupting the customer interface, with potentially devastating consequences. According to Andros Payne, “The front-end functions are the most tricky to merge. Differences in offerings, target customers and sales channels, and the value of personal relationships, all need to be taken into account”.

> The merged go-to-market operating model worked well because it delivered a clear positioning for each brand and product for each customer segment.

Stijn Vos
CEO, ESDEC Solar Group

In the case of Gilde's transformational acquisition of IronRidge, EcoFasten and Quick Mount PV, each of the acquisitions had a different go-to-market – direct, indirect through distributors, and a mix. In order to merge Sales & Marketing functions without creating channel conflict, the go-to-market operating model was refined, with carefully aligned brands and selected product offers by segment.

Customer-facing parts of IronRidge and Quick Mount PV were merged to build a larger distributor-only go-to-market function, while EcoFasten's go-to-market was kept separate to focus on large direct-sales customers with dedicated products and brands. According to Stijn Vos, CEO of ESDEC Solar Group, "The merged go-to-market operating model worked well because it delivered a clear positioning for each brand and product for each customer segment".

However, one size does not fit all. Each case needs to be evaluated on its individual merits to determine the economic risks and benefits of merging, versus the costs of creating new interfaces or potentially jeopardizing accountability. There is rarely a textbook answer driven mechanically by empirical data. It's one reason why competent managers and subject-matter-experts from both organizations need to be involved to make the tough judgement calls on the merged go-to-market model based on their intimate understanding of the business and experience. Management participation also creates alignment and enthusiasm to strengthening collaboration. According to Vos, "Having leaders from the merging companies involved in defining the future org set-up really helped to create excitement in the management team, and later cascade this excitement to our employees".

Gilde Buy Out Partners and ESDEC Solar Group also leveraged best-practices by verifying that the new go-to-market organization would work with channel partners and end customers before implementation. In-depth, 3rd party interviews were conducted prior to "go-live", to verify that the new operating model would fly, before sales teams were merged. This had the desired effect. According to Vos, "There was no channel conflict or disruption to the customer interface after implementation. We grew sales above plan during the merger".

Integrating Sales & Marketing organisations is the most difficult aspect of a Buy & Build merger. However, with the right collaborative approach and facilitation, PE sponsors can activate Sales organisations and unleash top-line synergies.

SECTION 4.0

Getting the Soft-Factors Right

SECTION 4

GETTING THE SOFT-FACTORS RIGHT

Most managers and employees view a merger or acquisition with fear and suspicion. They see it as a zero-sum game, where one party wins at the expense of the other. It's a tough starting spot from which to build trust and collaboration needed for resolving a host of merger-related issues. In addition, according to Andros Payne, "Buy & Build acquisitions merge organizations with different values, cultures and norms - perhaps even direct competitors with historical animosity.

The risk of misunderstandings that lead to a breakdown of trust is huge," And, once a first impression is made among the leaders of merging organizations, psychologists tell us anchored views are difficult to reverse. Subjective perceptions quickly become reality and can damage the integration and realization of synergies. So, getting the soft-factors right from the very beginning, to build trust and understanding, are a critical foundation for Buy & Build success.

The starting point is eliminating the risk of misunderstanding by providing objective, fact-based transparency to each management team and organization on how the other company operates. Up-front clarity on functional management processes, but also organizational structures, ways-of-working, values, norms, culture and behaviors is the basis for building trust and collaboration. Getting otherwise subjective factors about each organization on the table to begin with, eliminates the largest source of potential misunderstanding when the companies start to interact. Without objective facts, managers inefficiently try to piece together an understanding of the other company from fragments they pick-up during initial meetings and communications.

For the consolidation of IronRidge, EcoFasten and QuickMount PV, Humatica was engaged as a neutral, third-party to conduct a group-wide organizational assessment including structures, processes, culture and incentives. According to Stijn Vos, “Listening and learning about each company on a standalone basis prior to merging was the key to building trust among the management teams. All executives now agree, this was the right approach to get to the right outcome. We are still benefiting from the collaborative momentum started from the beginning”.

Another step to build trust and alignment is to jointly define and anchor a common vision and purpose. As in the case of ESDEC, the three acquired firms in the US, combined with the European companies, created the first international leader driving the residential solar power revolution – a motivating and inspiring common goal and purpose for all companies, managers and employees. According to Payne “jointly agreeing and communicating a motivating purpose creates a new feeling of excitement in the companies. That by working together, they can do something much bigger than any of the standalone firms could have done alone”. In the words of an ESDEC manager, they defined a “BHAG” (Big Hairy Audacious Goal) to inspire team members every day – a common purpose to put personal sacrifices and unavoidable, sometimes painful, organizational changes in a positive context to reduce risk.

Overcoming the “agency problem”, whereby managers act in their own self-interest rather than the interest of the merged company is also important for executing a successful merger integration. Andreas Knobloch notes, “Solving the agency problem is critical for Buy & Build deals which need quick integration within a short holding period”. Providing equity stakes to leadership is a key lever with typically 10-15% of ordinary equity reserved for management. Aligning executive financial interests with the common purpose and merger milestones clearly helps.

How leadership manages the inevitable “moments-of-truth” in a merger also plays a role in building trust in the organization and the process. In particular, how are insecure leaders or those looking to (ab)use their power for personal advantage during the merger window dealt with? Executive actions in these cases speaks much louder than words. What senior leadership “does”, rather than what it “says” has a strong impact on culture, trust, collaboration and merger success. In particular, firing the right people in the wrong way is the surest method to derail the merger. The senior executive in charge of an integration needs high EQ to be able to interpret actions from the perspective of rank & file employees and make sure that changes send the right signals that promote constructive collaboration.

> Jointly agreeing and communicating a motivating purpose creates a new feeling of excitement in the companies. That by working together, they can do something much bigger than any of the standalone firms could have done alone.

Andros Payne
Managing Partner & Founder
Humatica

Buy & Build acquisitions are a great opportunity to arbitrage cultures. That is, taking the best of each firm’s culture and leaving the worst of each behind. If unmanaged, cultural differences are one of the main reasons why mergers fail. But “culture” is too broad a term and can mean many things. It’s therefore critical to break culture down to actionable unique behaviors, beliefs and decision-processes that can be compared and engineered in the merged company. The first step is to gain fact-based transparency on each company’s organization and culture. From this, the joint management can collectively define the culture they want to create, and document it. According to Knobloch, “once defined, the culture should be translated into concrete expectations for behaviors and anchored in collective values”.

Merger success is based on jointly making and implementing many good decisions on everything from leadership structures down to which suppliers to use for office supplies. The foundation for this is trust between the merging organizations at all levels – but clearly, starting at the top. Objective, fact-based transparency on each company’s strengths, weaknesses, culture, structures, processes and norms is the starting spot for avoiding misunderstanding and building trust. It’s the basis for engineering a collaborative merger that delivers on the promise of Buy & Build value growth.

SECTION 5.0

Integration Governance: Always Critical, Often Forgotten

SECTION 5

INTEGRATION GOVERNANCE: ALWAYS CRITICAL, OFTEN FORGOTTEN

Once a top-level target operating model and organization are agreed, that's when the heavy lifting starts. It's when hundreds of decisions on sub-structures, new or changed roles and interfaces at different levels need to be made. And, it's during this period of intense decision-making that proper governance of the merger process is essential to avoid confusion, misunderstandings, and delayed implementation.

Good governance starts by defining and communicating a well-structured and synchronized process by which merger decisions are made. The biggest and most common mistake is to appoint leaders to new/changed senior positions in the merged company and delegate to them the responsibility for "lifting-and-shifting" employees into their new buckets. Although new appointees may feel empowered by their nomination, this is in fact a "hospital pass" to selected managers. In the absence of clear governance, they don't have the time and resources to ensure that roles, interfaces and processes in their organizations are clear, are harmonized across the businesses and work properly. They only understand problems much later. When it is too late. It's far better to establish a clear governance process for making and implementing merger implementation decisions up-front.

A key element of good merger governance is a "Transformation Board" that gives final approval to new or changed sub-structures, roles and management appointments before they are implemented. This critical governance body should be composed of senior executives with high credibility from each merging company. Employees from each organization get the reassuring signal that they have a seat at the table and are represented when decisions are made. The Transformation Board's signaling in this regard is helpful in reducing fear, insecurity and the resulting dysfunctional behaviors that can erode trust between the merging organizations.

The Transformation Board's role needs to be rigorously communicated throughout the merging organizations. This will prevent dysfunctional decisions and actions by managers in the merging organizations. When it is clear to everyone that no decision is final and nothing will be implemented until the Transformation Board approves, managers will avoid pre-empting decisions in their own self-interest for fear of having those actions exposed or overturned by the Transformation Board. Hindering uncoordinated, ad-hoc manager actions during the merger ensures trust in the process and precludes miscommunication, misunderstanding and a breakdown of trust and collaboration.

An integration plan or 'roadmap' is essential for keeping the integration process on track and creating positive momentum in the organization. In order to make the perception of collaboration become a reality, the plan should be developed by managers from each merging company. The process of jointly developing the integration plan becomes part of the output in terms of ensuring a collaborative working relationship between the teams. This is also where a qualified third-party facilitator can help to drive clarity on the integration roadmap without triggering suspicion or distrust between the parties.

The plan needs to be developed quickly. "The longer you let things go, the more distracted people become" explains Andros Payne. Rapid integration allows the benefits of synergies to be realized sooner, minimizes the window of uncertainty for employees, and allows managers to focus on daily business sooner, rather than be distracted by the merger integration topics.

> Our bottom-up approach meant that different areas could be integrated in parallel by knowledgeable employees. It was fast and engaged our team members.

Stijn Vos
CEO, ESDEC Solar Group

Merger implementation workstreams should involve selected managers and employees from each company. According to Stijn Vos, "we established six merger workstreams for the Transition, Go-To-Market, Products and R&D, Supply Chain, Support Functions, Systems and Business Intelligence. Each team had a senior executive sponsor, a lead and subject-matter experts from each company". This approach worked well. Vos adds, "our bottom-up approach meant that different areas could be integrated in parallel by knowledgeable employees. It was fast and engaged our team members". ESDEC's best-practice merger governance empowered managers and employees who were given responsibilities for specific modules. Merger decisions were implemented quickly through this collaborative approach and talent was retained throughout the process.

Lastly, a Project Management Office (PMO) is essential for coordinating and governing different merger workstreams. The PMO's responsibilities typically include coordinating taskforces, setting the pace, tracking progress and ensuring deadlines are met. The necessary competencies in the PMO include conceptual and analytical thinking, the ability to structure information, outstanding written and verbal communications and the ability to lead through facts and positive persuasion rather than direct line control. It is a difficult role, requiring specialized skills.

The success of Buy & Build strategies depends on the value-enhancing merger of bolt-on acquisitions. This is especially tricky when consolidating former competitors within a geographic market or across national boundaries. Merger governance processes play a key role in the success or failure of an integration process. Establishing a well-defined merger process with clear governance avoids disruptive issues and ensures timely realization of benefits.

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Big data and pattern recognition is becoming more important in all fields, including management and leadership. In particular, data analysis is increasingly being applied to understand organizational behaviour and the aspects of culture which drive collective agility. This is of vital importance for improving the productivity of knowledge workers, especially in service-driven, post-industrial economies. Professor Kenneth Younge of Ecole polytechnique fédérale de Lausanne (EPFL) recognized this urgent need and developed the Data Science for Managers (DSFM) program to address it. Taught in English, the DSFM program introduces executives and managers to the programming tools used by data scientists to address real world business analytics problems. More information on his course is available at: https://www.dsfm.ch

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