



**BUY! BUILD! BUY!**

Buy-and-builds have always been popular private equity strategies. Done well, they provide a shortcut to growth and increasing value on exit. But there will be new reasons for turning to buy-and-build platforms as businesses get through the COVID-19 crisis, reports Marc Mullen

**D**isruption can be good for investors, but what we have seen in 2020 is off-the-scale disruption. Investors are experiencing a strange shock, so understanding the fallout from the sectors they are investing in is key to their plans for deploying capital. But, on the available funding side, private equity (PE) still has a lot of dry powder.

Buy-and-build strategies have been around as long as PE has been around, but the dynamics of many sectors and high valuation multiples have seen the number of build strategies increase in recent years. PE portfolio platforms look to acquire new products, new technologies, new markets and new skills, and look for 'synergistic' cost reductions - which may, in some cases, include reducing the overall number of people employed. Revenue growth can be achieved faster than by organic growth alone.

"The ultimate aim is to buy a business that meets a key strategic need, and that could be a need for new products, customers, new markets, technology or getting the benefit of scale. When you make such bolt-on acquisitions, the platform business becomes more attractive and more resilient, and therefore could command a high valuation compared to some of the smaller bolt-on

acquisitions," says Naveen Sharma, UK head of private equity at KPMG. "But bolt-on acquisitions should always be made with a focus on the strategic need of the business."

#### **GOOD MONEY AFTER GOOD**

According to KPMG's *UK Mid-market PE review* (published in January 2020), bolt-on acquisitions made up 56% of all UK mid-market deals in 2019 - an 'efficient and low-risk' strategy for PE houses.

David Collins, head of UK corporate and co-chair of the global M&A group at Dentons, says: "There will be more acquisition opportunities for buy-and-build PE-backed businesses as we get through and emerge from the crisis. But the availability and quality of those opportunities, and the ability to exploit them, will depend on a whole host of factors and considerations."

Potential changes in the capital gains tax regimes of different countries, including the UK, or changes to personal circumstances around work-life balance highlighted by lockdown are both expected to bring businesses to market that will be (relatively) stress-free opportunities for buy-and-build platform businesses.

Paul Joyce, head of Mazars' M&A team in London, says: "If you're a PE investor, it's much lower risk to invest and follow your



“The ultimate aim is to get multiple arbitrage – smaller acquisitions made at much smaller multiples”

**Naveen Sharma,**  
UK head of private equity, KPMG

money investing further in businesses with management teams you’ve already backed.” Indeed, PE investors may be a bit more cautious about creating new platforms for the time being and put their focus on building existing portfolio businesses.

Robert Moran, who leads restructuring M&A at PwC in the UK, sees carve-outs also providing deal flow for buy-and-build platforms. “The business might have been marginal for some period, it might not be financially stressed, but it might be seen as something that’s not core, and the parent is having to focus on its core business,” he explains. “PE may see an operational improvement story under independent ownership and tighter cost control by using their buy-and-build platform.”

#### STRESS POSITIONS

As the UK government’s various schemes (Coronavirus Business Interruption Loan

Scheme, Coronavirus Large Business Interruption Loan Scheme and Bounce Back Loan Scheme) are unwound, the consensus is that it will drive insolvency processes. How extensive that is depends on how the economy and specific sectors are affected in the longer term (see ‘Tough calls’, pages 24-26 in this issue of *Corporate Financier*). It also depends on how much debt the businesses are carrying and how the government and banks approach the situation. The companies that had fundamental problems and needed fixing will still need fixing regardless of the undoubtedly well-intentioned government help. But for others, it will have allowed them to keep trading, and if the fundamentals of the business are still there then they may well prove attractive targets.

“Businesses might be able to keep the lights on, but actually they need to use this time to make sure they are structured properly and operationally remain relevant to their end users in two years’ time,” says Moran. “The positive is that the problems might not be acute, but it may be that to be successful in three or four years it cannot be doing the same thing it is doing today.”

As companies slip from stress to distress and into potential insolvency, value can fall away pretty quickly. As a result, to ensure the integrity of the business, vendors and acquirers have to move quickly. Generally, ►

# 56%

of all UK mid-market deals in 2019 were bolt-on acquisitions, according to KPMG

#### GAMECHANGER

In September 2019, Panoramic Growth Equity invested in IT-managed service provider CMI, which has its headquarters in Belfast. It financed the acquisition of London-based IT specialist BTA, which roughly doubled CMI’s turnover to more than £11m and gave it 100 staff based in Belfast, London and Maidenhead.

Founded in 2009, CMI had grown through a mixture of funding – through its own resources, invoice discounting for working capital, and with several (smaller) acquisitions funded

by mezzanine and additional shareholder investment.

“Last year, our intention was to grow our business significantly,” says CMI founder and managing director Ken Roulston. “We knew we’d need new sources of funding and began to look at PE.” They needed less than £5m of investment, which didn’t suit some PE houses, but turned out to be Panoramic’s sweet spot.

CMI works up IT strategies, manages IT systems and supports IT departments in more than 500 organisations across the UK’s private and third sectors. It is Panoramic’s first investment in Northern Ireland.

“We were searching for potential targets for three or four months before we started talking to BTA, and during that time we kissed a lot of frogs,” Roulston explains.

He says there are four key components to any acquisition: “First, it must strategically fit. We’re more about growing what we’ve got and being experts in our market rather than diversifying too much. Second, there needs to be a technical fit in terms of what we do and the technologies we use. Third, there must be a financial fit – a sensible valuation will allow negotiation. Finally, and

probably most importantly, the difference between acquisitions that will work and ones that could fail is whether there is a cultural fit – how they view staff, customers and suppliers.”

The BTA deal was more of a merger, with different challenges. The BTA MD took on a consulting role and the FD stayed in post temporarily to help with integration. The rest of the BTA management team remained in place.

Partner David Wilson and senior investment manager David Atkinson led Panoramic’s investment. Atkinson says that backing management that has built a



**COMPLETION DURING COVID**



In August, ECI Capital portfolio company Arkessa completed the acquisition of Sim Services, a Netherlands-based connectivity services provider. The bolt-on will allow Arkessa to strengthen its presence in the Netherlands as well as improving its Internet of Things connectivity offering.

The deal was in motion before lockdown, and ECI, Arkessa and Sim management had met face to face. Then it went virtual. The fundamental reasons for the acquisition were unchanged by COVID-19, and a lot of the diligence had already been done, says Isa Maidan, an ECI investment manager (pictured). They were about three weeks from exchange when the UK locked down, so the deal was inevitably delayed.

“They are both people-light businesses, so there were no huge teams to introduce to each other as part of the integration,” adds Maidan. “The integration involves further developing our understanding of each other’s businesses and is focused on what can we learn from each other to grow sales in both organisations.

“I’d be lying if I said we hadn’t lost something by not being able to meet to do that. But we are not changing products or how they do things fundamentally. Integration is potentially far more problematic for some other business where the investment thesis is based on big cost synergies and there’s a more complex integration to be done. Our core thesis for Sim Services is more of the same.”

business through acquisitions is key: “A positive track record and strong interpersonal skills are very important, probably more so when doing buy-and-builds, because culture is a big determinant in whether the integration is successful or not. Management for CMI is now the existing CMI team plus two directors from BTA. There needs to be a good rapport between the team or it will be much harder to make work.”

Panoramic - a member firm of the Corporate Finance Faculty - plans to fund further acquisitions as opportunities arise. Roulston says that while valuations dipped in Q2, they have largely bounced back since. “The managed services



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**Ken Roulston,  
CMI founder and  
managing director**

sector is still hot because of the high levels of recurring revenue and the consolidation taking place in the wider marketplace. And I don’t believe valuations will change materially,” Roulston says.

He cites one acquisition they are currently looking at. The vendor had a deal agreed with an acquirer before COVID-19, but when price chipping began in March, they walked away. “They came back to us with what we had proposed before COVID-19,” he says. “We told them that as long as the business is doing what they say in terms of trading, we would have no reason to change our views.”

CMI’s aim is to get recurring revenue to more than 70% of turnover, and EBITDA from 11.5% to 15% ahead of exit. Roulston explains that stressed situations do not especially interest CMI: “Normally speaking, in our sector if a business is distressed it means there are fundamental issues within the business that might be very difficult to fix. We have a reasonably aggressive exit strategy, and so we don’t have the time to be dealing with problems in stressed business. I would rather bring in a decent business on a sensible multiple and then get the value accretion.”



“Buying cheaply is not necessarily buying well, so your diligence needs to be focused on the key areas”

**Paul Joyce,**  
head of M&A in  
London, Mazars

that means they need to be financed, probably from cash reserves or available facilities, as there will not be the time to raise equity or debt to finance any deal - firepower needs to be readily available.

“Diligence needs to be done in an efficient manner, because you need to know what you’re buying in stressed deals, but it will be in a compressed time frame,” says Joyce. “Buying cheaply is not necessarily buying well, so your diligence needs to be focused on the key areas. And you probably won’t be able to look at everything you would want to on a typical deal.”

Experienced special situations or accelerated M&A professionals can bring insight as to how to run a fast-track process. “They understand the specific challenges of those types of transactions, leading to better advice,” adds Joyce.

What has changed for the target businesses? And what remains the same? “There must have been a strategic reason why you wanted to do that acquisition before,” says Sharma. “You need to make sure it’s a sound business and there’s no underlying problem.

“You need to make sure that if it’s stressed, you really understand why. If it is because of a capital structure issue, then that is more than likely an attractive option because you can fix that through the deal structure and how you put it into your business. The business must have the fundamentals - strong customers and



## SECTOR-SPECIFIC DRIVERS

One Mobeus Equity Partners buy-and-build investment operates in the COVID-19-challenged travel sector. Having backed the £6m secondary buy-out of Ski Solutions in 2017, it was combined a year later with the £3.6m management buy-out (MBO) of Wilderness in Scotland to create Active Travel Group. The plan was to build out a broad range of activity-based holidays. It still is, says Mobeus partner Justin Maltz, although the route is perhaps rockier.

“In the current environment there is a lot of uncertainty in the travel sector - people are feeling a lot of pain,” Maltz says.

“There are a large number of stressed and distressed assets. We’re having conversations with very good-quality operators and brands, which wouldn’t necessarily have come to us a year ago. I think these opportunities will increase in the last quarter.”

In the travel sector, there is no absolute guarantee on how businesses will trade in the short term. “You have to believe you’re buying quality,” Maltz explains. “There is a higher level of risk in doing deals at this time, but you have to quantify that risk, making sure you have a resilient financial structure and will be rewarded appropriately for it. In the

longer term, as the sector recovers, well-differentiated operators with strong customer propositions will thrive - especially in niches like outdoor and adventure trips. But you need to be prepared for a longer hold period to reach and benefit from that recovery.”

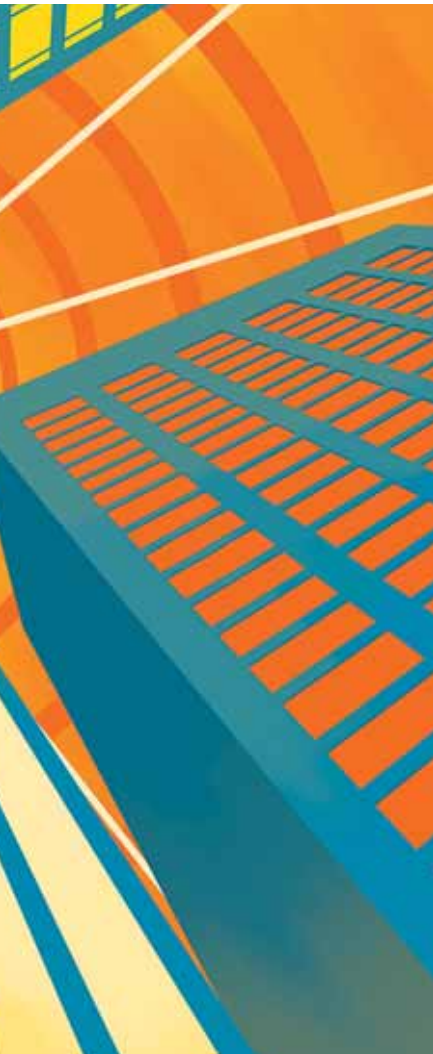
He says it may be that deals are structured with a greater proportion of the consideration deferred: “Innovation around the structure of these deals will be key to making them happen.”

But other sectors, such as healthcare, tech and financial services, are not in that same boat. And the drivers for buy-and-builds largely remain the same.



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**Justin Maltz,**  
partner,  
Mobeus Equity  
Partners



**“The reasons why you’re buying a business might remain, but you need to make sure that if it’s stressed, you really understand why”**

products, and a management team and culture that works.”

That sentiment is echoed by Isa Maidan, an investment manager at ECI Partners: “The only reason we’d be switching stuff off at the moment is if we think the quality of the business is no longer there.”

The current and imminent economic situation around the world may accelerate a buy-and-build strategy as organic growth prospects may dip. In extreme cases, investments that were not set up as buy-and-builds may see opportunistic acquisitions as a way to counter that slowdown. But the value-accretive rationale still has to be there. “They have to first make sure cash is preserved, costs are kept down and the balance sheet is strong,” argues Sharma. “If they then make an acquisition, I don’t think it will be just for the sake of it. It might be at an attractive multiple, there may be a new refinancing package, but it has to fundamentally fit with the business strategy.” ●

In 2017, Mobeus provided £8m to back the MBO of Ludlow Wealth Management, a financial planning business. Maltz sits on the board. Since the MBO, the company has made four acquisitions and grown AUM from £865m to more than £1.5bn. The business has averaged one acquisition every year for the past 16 years.

“This market is very fragmented. There’s a well-established trend to take advantage of that and create larger consolidators. We invested in building the management team at the outset so that they had the experience, ability and bandwidth to run their own business and make acquisitions at the same time, so they are often finishing one while talking about the next.”

Ludlow dines out on M&A little and often, acquiring businesses from founder-owners. Maltz says he sees deal flow “not necessarily coming from stressed businesses”.

“Some potential vendors are going through this period and thinking now is a good time to leave because of the stress of running a company through COVID-19, but they still prioritise finding a good home for their business that will look after their clients properly,” says Maltz.

**£3.6m**

MBO of Wilderness to create Active Travel Group

**LEGALEASE**

The COVID-19 crisis has caused buyers to consider a range of additional contractual protections from the sellers of targets. The vast majority will have been significantly affected since the start of the pandemic – negatively or positively.

“There has been more discussion over the inclusion of material adverse change (MAC) clauses, which are generally uncommon in UK M&A transactions,” says David Collins, UK head of corporate and co-chair of the global corporate group at Dentons. “They give the buyer the right to terminate in certain circumstances relating to a significant adverse change in circumstances affecting the target.”

Some buyers are also looking for more controls and oversight in respect of the target business during the period between signing and closing of the transaction, he adds. They are also seeking additional warranties to deal with specific concerns arising from the crisis, such as the:

- target’s relationship with its material suppliers and customers;
- status of material contracts;
- collectability of debts;
- efficacy of business continuity and disaster recovery plans;
- resilience and adequacy of IT systems; and
- exposure to claims under employment laws and other litigation.

“Due diligence is also inevitably focusing heavily on these areas,” adds Collins, who is also a member of the Corporate Finance Faculty’s board “Additional specific provisions in price adjustment and earn-out terms are also being included in transaction documents to deal with items that have been particularly affected during the crisis and its impact on working capital and trading.”