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Add-on Acquisitions: Benefits to Buyers and Sellers

Background

A business Buyer (particularly a private equity fund) often distinguishes acquisitions of companies that would be a “platform” deal or an “add-on” deal. Typically, a “platform” acquisition refers to a company that the Buyer acquires and which is big enough to be used as a base for the platform company to acquire (“add-on”) smaller companies.

An “add-on” acquisition is one of the most efficient types of business acquisitions. In these types of transactions, a buyer purchases a business that provides a core competency at a relatively low cost and quickly integrates it into an existing or new division of the Buyer. This article outlines the potential advantages these deals offer for business Sellers, but also notes that they can require tough adjustments — particularly for entrepreneurial business owners who are accustomed to independence.

”Add-on” acquisitions are efficient and advantageous in certain circumstances

An “add-on” acquisition typically is very efficient and accretive to the Buyer’s net earnings. In these types of transactions, a Buyer purchases a business that provides a core competency at a relatively low cost and quickly integrates it into an existing or new division of the Buyer. By acquiring a company that is already established in a market or technological capability, Buyers can quickly roll out the new business, offer a new product line or enter a new geographic region. In many cases, this strategy is less expensive and faster than generating new business internally.

By the time a business Buyer approaches a Seller, the Buyer typically has already determined how the business will integrate into the Buyer’s own operations and how much it can afford to pay the Seller. This can cut down on due diligence, negotiation and integration time.

“Add-on” deals offer potential advantages for certain types of Sellers. For example, an add-on acquisition can be an ideal next step for a technology start-up that has expanded as far as it can, given its current capital constraints. Add-on deals, however, can require tough adjustments — particularly for entrepreneurial business owners who are accustomed to independence.

Cherry-picking

“Add-on” Buyers typically seek to acquire specific assets (such as a single product line, a research and development team, a manufacturing plant, or a trademark) at a cost lower than it would take for the Buyer itself to develop that specific asset. Buyers intend to realize cost savings with greater economies of scale and other synergies that can be achieved when the company integrates the Seller’s specific assets with the Buyer’s existing assets.

As a result of integrating only specific assets of the Seller, the Buyer may dispose of the Seller's other business assets. For example, the Buyer of a software company may keep the Seller's developers but lay off its marketers because Buyer may already have a well-staffed marketing team.

On the other hand, if a Buyer is using an add-on acquisition to enter a new market, the Buyer may make retain most of the Seller original assets and management and operate the newly-acquired business as a subsidiary or a separate division of the platform company. Such was the case when, in May 2012, slot-machine maker WMS Industries acquired online gaming developer Jadestone Group to replace WMS' underdeveloped online operations.

Best candidates

Several types of Sellers can benefit from an add-on deal — for example:

- Fast-growing start-ups and entrepreneurial owners that can use the resources of a larger company to expand,
- Financially troubled companies looking for a last-chance deal, or
- Smaller businesses that have a particular product or dominance in a niche market or a nascent industry.

Sellers should look before they leap

Add on acquisitions are not a panacea, especially for business owners concerned about preserving their business culture and workforce. At a minimum, a Seller's business will lose some strategic flexibility. And the Seller's owner likely will have to change its internal business operations and standards to comport with what the Buyer's existing operating procedures. Even if a Buyer keeps the Seller's business intact as a separate division, that separate business division will have to compete for attention and resources with the Buyer's well-established other divisions.

For Sellers, particularly small start-ups, a tuck-in deal could be an option. Keep in mind that accepting such a deal means, in some cases, that only the assets and personnel the Buyer deems valuable are going to make the transition to the new ownership.

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