Roll-Up Deals

When is more than two better than one?

A roll-up deal occurs when a buyer acquires several businesses and combines them to form one larger company. This type of transaction is somewhat unusual, but it offers an intriguing option for certain buyers and sellers. A small business that would like to become part of a large, multinational company, for example, could find a roll-up appealing. Buyers looking to head off small competitors before they become major threats might also consider this strategy.

ON THE WAY BACK?

Roll-ups were popular in the 1990s and early 2000s, but they got a poor rap in some circles for being hastily thrown together deals that lacked integration plans and long-term strategies. This reputation isn't surprising given the fact that the goal of many roll-up buyers, particularly in the high-growth technology sector, was to combine companies, swiftly initiate a public offering of stock and then cash out.

Roll-ups have been less common in the recent rocky economic landscape. But the roll-up model, when executed correctly, can be appealing for certain businesses. The CEO of wireless prepaid phone service provider MetroPCS Communications, for example, recently stated that his industry is ripe for roll-ups. It has room for only two or three main players, he claims, but currently has five major ones, as well as a host of regional companies — all vying for the same business.

STRUCTURAL DESIGN

In a typical roll-up, the buyer acquires two or more "founding companies" that it then combines into one overall structure — a newly created holding company, for example. The founding companies are converted into subsidiaries of the new company, though buyers can also merge the various companies' operations into one overall structure.

The success of a roll-up depends on the financial strength and smooth integration of the founding companies. Prime roll-up candidates usually:

Belong to certain sectors. The best roll-up targets are generally in industries dominated by small, regional businesses, such as funeral homes, recreational vehicle retailers, technology service providers, florists and landscaping services.

Don't cannibalize their partners. The merged companies shouldn't eat into one another's business. Ideally, the rolled-up companies offer different or different-stage products (such as one making machine parts and another machine structures). Businesses that cover different geographic areas also are good candidates.

Keep management on board. Rolled-up businesses must be committed to the success of the new venture — owners can't simply look to cash out and retire. The merged company's board of directors typically is made up of representatives from all rolled-up businesses. And upper management often stays on after the transaction is completed.

MECHANICS OF THE DEAL

Rather than slowly assembling the roll-up deal piece by piece, the buyer opens negotiations with all potential selling businesses simultaneously. The buyer signs letters of intent with all sellers and conducts due diligence concurrently.

If a public offering is planned, transactions with every selling company are pegged to close when

Help your roll-up avoid bumps

Because roll-ups involve more than the typical two parties, their chance of hitting bumps in the road to a successful closing are higher than with other M&A transactions. Sellers can help keep their deal from collapsing by:

- Remaining realistic during negotiations about what they offer their buyer — whether it's cost savings, future revenues or new customers,
- Beginning integration planning as soon as deal negotiations get underway, and
- Keeping the lines of communication open.

Roll-ups can be easy when all sellers become subsidiaries of the new company and remain largely intact. But they can be difficult when sellers combine their operations. In any case, there's likely to be a fluid period during which new chains-of-command are developed, management is restructured and divisions or product lines are shut down. At this stage, excellent communication with all of the rollup's parties is critical.

the combined entity goes public. So the timing of a roll-up deal can be extremely tricky, requiring the advice and assistance of experienced advisors.

NOVEL APPROACH

Roll-ups aren't for everyone, and they easily can collapse if they aren't carefully considered or don't receive the right guidance. But buyers with aggressive growth plans and sellers seeking a role in their company after the sale may want to consider this novel approach to an old challenge.