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Acquisition and divestiture

Unraveling the dynamics of acquisition and divestiture against the backdrop of the business life cycle curve.

From the wealth of published information as well as our own direct experience, Chemark finds there are many and varied reasons to acquire or sell a privately held business.

When considering a pro-active acquisition tactic, we see the following individual reasons or combinations of reasons in use:

• An opportunistic situation occurs, which, in the owners rationale, adds to the perceived value of the business and was NOT planned for.

• Strategically, an acquisition is required to fulfill the owner's perception of the tactic to use. This would be employed when one wishes to enter a new market, add product lines, change business course or, a combination of all.

• Remove a competitor from the market.

• Create a new market dynamic. Less than five competitors in a given segment can dramatically increase margin control and, therefore profits.

The mirror image of an acquisition is divestment. In this case a whole new set of reasons are employed when an owner feels the need to divest:

• Retirement of the owner and no interest or heirs exist for an inheritance route.

• Relatively substantial capital reinvestment is required to survive or to achieve the next vision for the business.

• It's a "sellers market" and the perception is that it won't get any better if the owner waits.

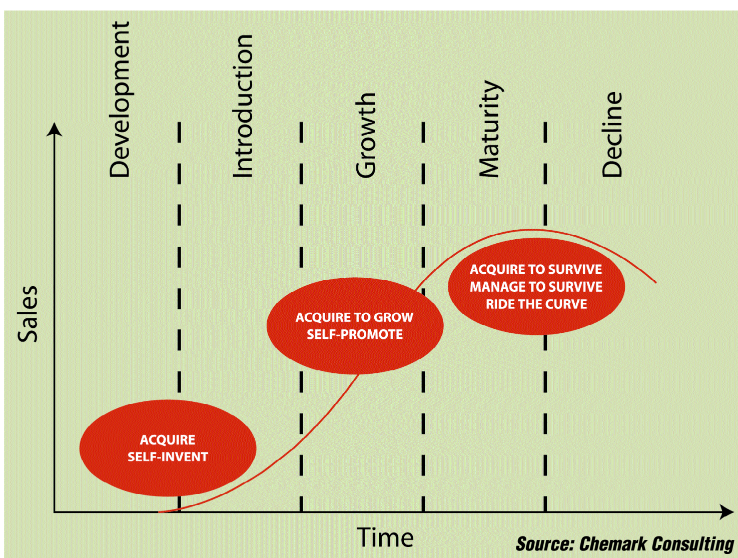
• The owner can sell, for one of the reasons outlined above, and remain active and viable in the business acting as a consultant or manager in the acquiring company's operations.

The Business Life Cycle Curve is a useful tool in determining a product, company or industry's position in the aging process. Knowing where one's location is on the curve in many cases dictates ones strategy as well as actionable tactics.

ACQUISITION

The opportunistic and strategic elimination of a competitor, or creation of a new market dynamic acquisition scenarios should be considered against the life cycle backdrop of

Acquisition and the Business Life Cycle Curve



your business situation.

When considering any of these acquisition scenarios, all positions along the life cycle curve depicted (*see chart on previous page*), can potentially be assisted. For instance, a product line acquisition can substitute for self-development and launch the business into a "Growth" position much faster. Or an acquisition of a business in the "Growth" portion of the curve can rescue a business that is languishing in the "Mature" curve position. At the same time an acquisition of a "Growth" business or "Growth" product line can literally save a business whose position is in the "Decline" phase of its life.

DIVESTITURE

Divestment is too often wrongly considered a negative or reactive tactic. We believe that it is very plausible to consider divesting as a very positive action for the main players as well as the affected employees.

However, when placing the business into the life cycle curve (*see chart to the right*), we find that there are entirely different tactics involved in divesting when contrasting one stage to another.

For example, one of our clients developed an invention that was unique, making it differentiatable. It worked, it was simple to demonstrate, its customers could grasp the high potential quickly, a reasonably large market existed and it would resolve several identified unmet needs. In addition, it was attached to a value proposition as a system that increased the value of the user.

However, our client faced the prospect of building or acquiring a manufacturing, marketing, sales and channel to market infrastructure to fully take advantage of their innovative product line. Their investors wanted a high return on the short and medium term which was not impossible but still tough to accomplish. We advised selling the invention to a company with the appropriate infrastructure and proven abilities on the basis of an appropriate up front cash infusion but with a five-year payout.

Of course, the ideal time to sell for greatest monetary and control gain is when the business is in the "Growth" stage of the cycle. Usually the "Growth" stage has few competitors because margins are higher with substantial upside remaining. In other words, "all boats float" in this stage.

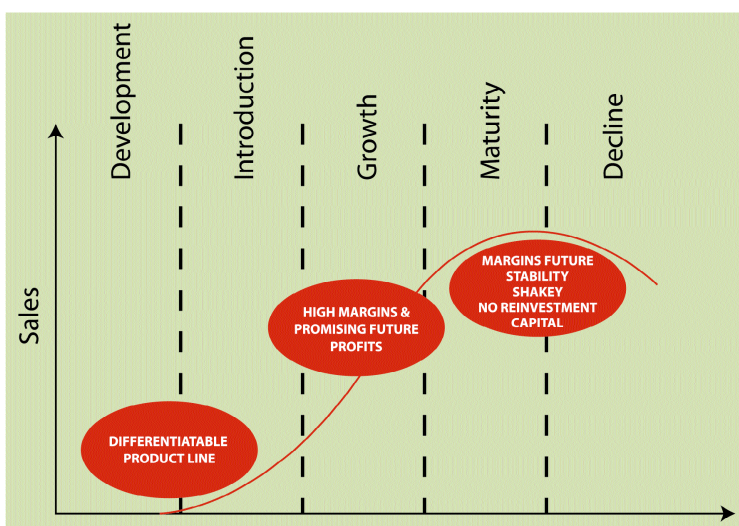
In a "Growth" stage of a business, the main downside for the owner in selling, is the loss of future earnings. Like the unique differentiatable table invention stage, this is exactly why the owner must know his value proposition inside and out and couch the sale in both current and future earning potential.

Unlike both the "Development" and "Growth" stages, the "Mature" stage offers a different set of considerations when viewing a business divestiture. The "Mature" business is usually one that faces many competitors, resulting in not being able to offer differentiation in combination with margin pressures.

In the "Mature" stage, there are those businesses that continue to do well and contribute enough cash flow that not only sustains it but contributes to new product development and potential growth opportunities.

However, if you are not in good shape, divesting may be an option. In this situation, a preliminary tactic of dieting may be called for. That is, a diet in the form of not only managing your price/cost ratio as efficiently as possible but also managing what Chemark calls, "the other side of the ledger," or the balance sheet. By accelerating your collectables and minimizing your inventories, you can exponentially return cash to your bottom line and, in the combined process, become a much more attractive acquisition candidate than other mature businesses. ***CW***

Divestiture and the Business Life Cycle Curve



Source: Chemark Consulting