



# DEVELOPING M&A DEAL FILTERS



M & A is not a straight forward process. Every client engagement is unique and challenging

## Developing Objective and Effective Merger & Acquisition Deal Filters

### Executive Summary

For a company to grow a potent combination of organic and M & A initiatives needs to work in combination. In today's rapidly evolving business space the company that can generate sustainable growth from organic means alone is rare.

Against this backdrop it is surprising how many companies still undertake Merger & Acquisition styled activity without a structured process of originating and then investigating potentially suitable targets. Failure to adopt such a structured process typically results in considerable resource and capital being expended in pursuing potential deals that are far from ideal. Worse still, often those deals are closed and what is termed "Winners Curse" eventuates.

LCC advocates a formal and pro active approach to the origination of suitable M & A targets which will fit in with the core strategy that the client seeks to pursue. In the development of a sustainable but flexible deal filter approach the client benefits from clarity of purpose in pursuing M & A, with standout benefits being:

1. A simple tick or flick approach, where 'first cut' filters allow potential candidates to be listed or parked from a reference perspective. LCC believes that this basic discipline alone results in the removal of emotion and potential 'deal frenzy' while typically leads to a poor transaction result
2. Prioritisation of initiative, which allows for high quality candidates to be given attention and resource, and low quality to be parked
3. A smoothing of strategic thinking to ensure that only those opportunities that are consistent with the direction of the Company are considered

The disciplined approach also results in more opportunities to deeply engage with critical stakeholders for any deal – be those stakeholders internal or external. This is of particular relevance for public companies, where standards of corporate governance and risk / opportunity metrics are critical to any decision to pull the trigger on an M & A opportunity. Boards are not applauded for bad M & A practices.

This abridged version of a detailed LCC client paper covers off basics that should be considered in the development and execution of a successful M & A acquisition filtering initiative.

For a full version of this paper please do not hesitate in contacting LCC



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Is the core strategy blessed by all stakeholders?

## Step One - It Starts with Strategy

The most critical step off point for a Board of Directors or CEO is why do you want to pursue M & A in the first place? What is the benefit that is anticipated such an initiative will deliver?

LCC typically spends a considerable amount of time with its clients in discussing the objectives of an M & A process against a backdrop of market information such as activity within the client's sector both domestically and internationally, valuations and deal structures.

Having access to the most up to date deal and market information we find is critical for clients to appreciate the competitive landscape in which they want to pursue any M & A initiative. If private equity players are effecting consolidation plays in a sector where the client wants to transact, for example, competition for high quality companies might be extreme – driving up valuations and premiums and accordingly, increasing the risk of deal failure (*financially*).

So Step One is to understand core strategy against a backdrop of specific and detailed current and projected industry market and competitor information.

What are the drivers to doing an M & A deal?

## Step Two – The First Cut

Once it is clear the purpose and objectives of the M & A initiative, the next step is to construct a specific 'filter' which will allow candidates to be considered and included. It is important that the initial filter is not so narrow as to be exclusionary – one wants as many credible companies on the list as possible.

That list should be built into a 'living database' which allows continual reference to the universe of targets to take place. Within that database fundamental information can be held which from time to time is refreshed. As such potential targets might become priorities one day, although initially they only form part of the wider list.

Building up these lists is a bespoke process conducted with a 'bottom up' approach. One size does not fit all, specifically because each client's strategy has its own unique characteristics.

Things that might be considered in forming a high level strategy can include:

Geography	<i>A client wants to increase its relevance within a specific state / region. For example, a client wants to grow from a regional to a national presence over 2 to 3 years</i>
Product	<i>A client wants to acquire products that are complimentary to its own. For example, products that might be able to be delivered down the same supply chain with a minimum of change to existing operations</i>
Service	<i>A client wants to introduce additional services that are complimentary to its own. This may be of particular relevance if the client is looking to move quickly into a space where 'building' will be too difficult or take too long given the nature of the service industry</i>
Customers	<i>The client wants to increase its customer mix by number or quality. This can be of particular relevance if market entry / market expansion styled strategies are a priority</i>
Size	<i>The client wants to increase its market share or "share of wallet" within a particular customer set. For example, a supply company wanting to increase level of business with identified leading mining houses</i>

There is significant analysis and research that needs to be carefully considered in ensuring that the global list of candidates is complete, but on target with the CEO's strategic thinking and intent.



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Successful M & A filtering is an ongoing process of investigation and discussion

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## Step Three – Second Cut

Once the universe of candidates has been developed, a more rigorous filtering process of from which priority targets can be developed is actioned.

Given the nature of M & A the process of generation and re-generation of quality ideas and priority targets needs to be disciplined and ongoing. Not all targets will be interested in talking, and of those that are, not all will see deals conclude on satisfactory terms to LCCs client.

The later fact illuminates one of the key benefits of the rigorous and objective filtering process. Only deals that meet predetermined criteria will be considered for progression. Of course the framework of filter can evolve and 'flex', but at its core is a set of 'rules' that are closely and objectively followed.

Second Cut filters that LCC has constructed for clients historically have included such elements as:

<b>Market Share</b>	<i>The candidate needs to hold a market share, be that within a specific market, a regional market or a national market. Additional investigation of the candidate might involve understanding how that market share has ebbed and flowed over time, and competitors within the market space both regionally and nationally</i>
<b>Growth Profile</b>	<i>The candidate must have delivered year on year growth within a pre-determined range. That growth can be in terms of customers, profitability or other metrics</i>
<b>Leadership</b>	<i>The client wants to bolster its human resource capabilities by acquiring businesses with leadership – be that company wide or technical (as examples)</i>
<b>Accreditations</b>	<i>The client wants to acquire businesses that have specific accreditations with industry bodies or alternatively state or federal licenses to conduct business</i>
<b>IP / Skills / Knowledge</b>	<i>The client wants to acquire candidates that have high levels of IP / Knowledge / Skills. These can range from soft skills through to specific hard skills that are linked to equipment, software, or other 'capital' items</i>

The successful application of the Second Cut filter will produce a distilled list of credible targets over which detailed profiling activity can take place. A combination of research and access to information is critical to understanding which of the Second Cut list should be elevated in terms of overall priority.

## Step Four – Check & Balance & Action

Once the detailed list of targets is produced the opportunity for wider stakeholder input can take place. LCC's experience is that it is important that Boards of Directors, for example, are well briefed on the process that has taken place in developing thinking on the relevance of M & A in general, and the attractiveness of the selected targets specifically.

Involvement of stakeholders at this stage again allows the entire process to remain disciplined, transparent and structured. Board's can be satisfied that any activity is taking place against a backdrop of activity that has resulted in a rigorous and objective process being the outcome.

Activity can then progress with a 'one team' approach, based on a clear strategy with the efficient use of resource.

The building of a pro active front end loaded M & A Acquisition Filter of course takes time, expertise and resource. In LCC's experience and opinion, however, when executed with precision the payoff for that up front investment is a highly professional and effective M & A growth strategy delivering quality and considered acquisition candidates.

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