

# ASIA Pacific

Bottled Water

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China and the WTO: will horse power provide the next great leap forward for bottled water marketers?

Special report



All over the world, water cooler companies are changing hands. Many in the industry were tempted to call 2000 "the year of consolidation," but the number of coolers changing hands has also been high in 2001 and the number of individual transactions has shown no sign of slowing.

**Lance R Tullius of The Tullius Company** considers that, in today's bubbling merger and acquisition climate, knowing when to buy or sell is as important as knowing whether to buy or sell.

# Timing is everything in finance and acquisitions

*"My competitor sounds as if he's interested in selling his business. Should I be the buyer?"*

*"I've been thinking of selling my company for some time. Is now a good time?"*

*"We have an opportunity to improve our market position. Should we consider a recapitalisation?"*



us to believe that the timing is right? And furthermore, do certain circumstances suggest that the timing is right to make an acquisition, pursue a sale or entertain some other sort of strategic move?

"It seems that so many of us, by nature, want to buy. We equate buying with control, power, expansion and growth – all terms that are synonymous with making us feel secure and good, as if to assure us that we are moving in the right direction. But similar to any other major decision, there is a time to buy and a time not to buy."

These are amongst the most frequently asked questions, particularly of late, at **The Tullius Company**, a company based in Portland, Oregon, United States, which specialises in providing merger and acquisition and financial services to companies in the bottled water industry.

So if these questions apply in the massive and mature American market, do they apply equally in the Asian and Australasian bottled watercooler industry? "Absolutely," is the reply from Lance Tullius as he sums up the questions. "Simply put, the core of each question can be traced to timing. That being, 'Is it the right time to pursue a strategic move?'"

"Generally, our first response to any such inquiry is to remind the client that nobody possesses a proverbial crystal ball. As we all are aware, the unknown is an inherent rule of doing business. But what factors might lead

## Pursuing an acquisition

What factors should be considered prior to pursuing an acquisition programme?

First, a plan must be created. This will help to validate whether purchasing one or more other businesses is prudent or unjustified. For instance, what many potential buyers fail to consider is the state of the current merger and acquisition environment in their industry and/or market.

For several years now, the bottled water business all over the world has been witness to major consolidation, with large amounts of capital being deployed into the market. This has helped to create an environment that is generally favourable to sellers, with aggressive pricing, terms and conditions being

offered by multiple buyers from within and outside the industry.

Before pursuing a buy strategy, the impact of the current consolidating activity should be considered. For instance, there is a better than average chance that a new buyer will be competing with other better capitalised buyers for the same acquisition targets. Furthermore, these buyers may be operating under a different set of buying parameters that essentially enable them to justify paying a higher price for the same acquisition target. Value is subjective and can vary from buyer to buyer.

Accordingly, it's vitally important to price a business as a function of what it will return to you rather than what other market players perceive its worth to be to them. Building a plan that addresses the state of your particular environment will be pivotal in determining whether to pursue any acquisitions and could ultimately save considerable time and money!

Also, fundamental to any acquisition plan should be a clear understanding of how a particular acquisition will impact the value of the acquirer's business. In theory, the answer to this question should have the greatest impact on whether the timing is right to acquire or not. For if a thorough plan cannot comfortably justify that an acquisition will add value to the purchaser, beyond what is being given as consideration, the acquisition should not be pursued.

As part of this plan, the buyer's own exit strategy must be considered, to address whether the anticipated value of the acquisition will be realised prior to the buyer's desired exit. If not, how the acquisition is priced and/or whether it is made at all need to be re-evaluated. In the direct delivery bottled water business, for example, a key measure of value is the density of the accounts within a company's service territory. Assuming appropriate product/service pricing and a competitive operating cost model, greater account density will yield a more effective and profitable business.

Therefore, priced appropriately, an acquisition that brings with it accounts overlapping the acquirer's existing service territory can be very accretive to value and thus an appropriate strategic move. A comprehensive and effective plan will not only identify compatible acquisition targets, but also help to determine what value can be generated as a result of the acquisition. If, in fact, it makes sense to pursue an acquisition, this process will also help to establish pricing parameters.

## The cost of capital

In many instances, certain circumstances might indicate that a good opportunity exists to buy, while others suggest the opposite. For example, several strong fit acquisition targets might be available in a given market. Accordingly, the prospects of an acquisition appear attractive. Nevertheless, the acquisition will bear a significant cost. How will this cost be capitalised?

Regardless of where the capital comes from, be it through equity already in the business or outside third party financing, it will come with a cost. Whether the appropriate amount of capital is available and at what cost it can be obtained, will greatly impact the viability of an acquisition plan. And, in fact, the availability and cost of capital is in some respects a function of timing.

As a matter of fact, it's not exactly a great time to be raising growth capital. First, there have been many well publicised roll-up or consolidation attempts in all sorts of industries that were disastrous failures. This has generated scepticism within the investment community.

In addition, while the bottled water business includes characteristics that are generally attractive to institutional capital sources, unless already the beneficiaries of an industry presence, these sources most often cannot justify the aggressive pricing reflective of the current consolidating environment. Remember that in consideration for equity funding, the financing source is essentially buying a piece of a business. The value of that piece of business will be relative to the value of the entire business and this will be a function of current market conditions.



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## Fine line between buyer and seller

Often the line between being a buyer and a seller can be very fine. With regards to the bottled water business, The Tullius Company has worked with numerous companies that at one point labelled themselves "buyers" and even made an acquisition or more, then very soon thereafter became sellers.

In theory, almost every buyer will eventually become a seller at some point in time. That, of course, is the nature of a market. However, many of the supposed "long term" buyers within an industry become sellers sooner than they had originally planned. For the most part, the market's timing altered their original plans.

For example, a prospective buyer in the process of pursuing acquisitions may discover that the pricing they are able to

justify is simply not competitive with other buyers. Continuing down the same path will be counter productive. As a buyer assesses the market's pricing, they may determine that at that pricing it makes no sense to pursue an acquisition strategy. And often, in fact, considering that same market's pricing, it becomes attractive to pursue a sale.

## Becoming a seller

Because of existing market conditions within the bottled water industry, many industry players have simply determined that the timing is right to sell their business. What factors generally motivate a buyer to become a seller? For that matter, what compels anyone to sell their business? And along those lines, when is the right time to sell a business?

As with buying, a variety of circumstances factor into the desire to sell. But, unfortunately, market conditions are far too often not among them. It seems that too many of us are driven to sell because we either are ready to do something else or - especially in the bottled water business - lack the capital to grow our business further.

While these are certainly valid and understandable reasons, they aren't motives that generally would appear to put us in a position of strength at the negotiating table. At the same time, we all as sellers have one thing in common. That is, we want to maximise our value! In other words, we want to sell for the highest price. So, how do we do that? Furthermore, how do market conditions and timing play a role in maximising value?



## The value of one's business

If you've yet to figure it out, my point with respect to selling a business is that the time at which a business is sold is a fundamental component to value. Accordingly, always pay close attention to what is happening in your industry.

Many entrepreneurs seem to think that the value of their business is strictly a function of its internal condition. They are so emotionally tied to their company, they fail to realise that, however unfortunate it may be, a company's value is very much dependant upon external conditions largely outside their control.

As a result, these owners tend to sell when they think their value is high, as measured by internal performance, when in fact they are often not maximising their value.

For example, several years ago, a particular company had enquired of us concerning our thoughts on their market and ultimately, whether we thought it was a good time to sell their business. At the time, this company held the number three position in its particular market - a good market by the way - and was the leading independent (non-major) provider in the market.

Positioned as the number one and two players were two of the industry's major providers with operations in the region. Further, there were two significant companies that served as the number four and five market players. The independent company that we spoke with was generating good revenue growth, had a strong earnings history and a good management team - overall a very good business. The two majors were in a battle for market position and had been knocking on his door in an effort to acquire his business for some time. In addition, we knew that other buyers not presently in the bottled water industry would also have an interest in this business if approached appropriately.

Knowing all of this and considering what we heard to be the objectives of this owner, we strongly recommended a sale be considered.

The owner felt there was further growth to be had and was convinced that, with this growth, the value of his business would increase correspondingly. Fast forward two years later and several things had occurred. First, on one count, the owner was right. His business did grow and even at a slightly greater pace than anticipated. He was still profitable and had actually improved his management team. During this same time, however, the number four player sold to the market leader, and shortly after that the two majors in the market

consolidated their worldwide operations through a merger.

Some time after this market activity, the gentleman called again and sounded as if he were thinking sell. Again, he wanted our thoughts. Unfortunately, while we told him that his business was certainly saleable, because of market changes, the value in relationship to what the business was generating had decreased.

The number one competitor was now significantly bigger, and with that was of the mindset that it didn't really need this company to add significant value to its market position. In other words, It certainly would entertain a purchase, but at much lower pricing than it would have paid just a couple years ago.

So, while this gentleman's business was internally stronger than ever, because his market value was also reflective of outside conditions, the value of his business was, in fact,

less than it was when the business didn't appear to be as strong. The business was still sold at relatively attractive pricing, but simply because of timing, significant value was lost.

## The need to plan

Also vital to maximising value is the need to plan. A successful plan will be driven towards a culmination, generally an exit strategy. Again, it is not so important to set a definite exit point, as it is to establish a time range (perhaps three to five years) and then identify what should be accomplished during that time. Included in the plan should be a model forecasting various financial and operating information.

Constructed properly, the model will determine approximately how much capital will be needed to reach the desired exit. Far too many entrepreneurs fail to appreciate the connection between financial growth and required capital. A business simply cannot sustain growth without adequate capital. When capital runs dry, a business owner's options often become limited.

With respect to forecasting, think about where and how any revenue and profit growth are going to be achieved.

Will you grow in your existing market, servicing customers with the same products/services?

Or have you identified new markets, products or services?

Make sure that all infrastructure needs have been addressed. Particularly what, if any, additions to management will need to be made? Strong people in appropriate roles will often add more to an operation's value than any other characteristic. Simply put, people make things happen, including value!

Finally, think about what you will do, as an entrepreneur, after your business is sold.

Do you want to continue with the buyer in some capacity, not necessarily similar to your existing role?

Can you work within a larger corporate structure?

Do you want to do something else?

The answers to these questions will have an impact on both timing and value. Don't underestimate them. They matter!

While nobody can guarantee the right time to make a significant business move, we can all make efforts to minimise the unknown.

Ultimately, the right time can vary for everyone. But whether considering a purchase, sale or other event, realising the effects of outside or external conditions, not just those peculiar to your business, will pay major dividends.

And remember, timing is everything!

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