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Mergers & Acquisitions: When to Buy Your Rival

For Billtrust CEO Flint Lane, the acquisition made perfect business sense. But could he really write a big check to his longtime nemesis?

Bare-Knuckle Flint Lane and a rival had been battling for years.

Flint Lane sighed deeply. Here we go again, he thought. The CEO of Billtrust, an electronic and paper billing service, was meeting with a customer near Los Angeles when the client told him about a lowball bid he had recently received from Lane's main rival, Invoice Connection. The customer said he was happy with Billtrust, but the low-cost alternative was hard to ignore. "He said to me, 'I know you guys are better--but are you that much better?'" Lane says.

And so, just as he had done numerous times, Lane made his case. He outlined the ways in which Billtrust was better than Invoice Connection and gave the customer a list of four clients who had bolted Billtrust only to regret the decision. The client wound up staying put. But Lane was fuming. He was sick of fending off such poaching attempts. And then there was the timing. The very next day, Lane had a lunch meeting with Invoice Connection co-founder Earl Beutler--at which Lane planned to ask his rival if he was interested in selling.

In fact, despite the ill will between the companies, a deal made perfect sense to Lane, who had just initiated an aggressive acquisition strategy. At least it did on paper. But deep in his gut, Lane couldn't stand the idea of essentially rewarding a competitor who had been such a pain. Says Lane: "I'd be writing a check to these guys who copy what we do and undercut us on price, to these guys who we hate."

1. The Backstory

The acquisition hunt begins

Lane founded Billtrust in 2001 to provide businesses--mostly wholesalers of plumbing, electrical, and lumber supplies--with online and paper billing services. He thought it was an underserved niche, and he was right: Revenue at Billtrust grew at least 50 percent a year. In 2006, venture capitalists kicked in $4 million in exchange for a minority stake. But in 2011, as sales hit $35 million, the growth rate began to slip, to 30 percent. Lane and his investors, who intend to go public, weren't about to settle for flagging growth. So they decided to go acquisition hunting.

One of the companies Lane's investment banker suggested was Invoice Connection. Lane knew the business well. A division of Pinnacle Information Systems, a software company in Carlsbad, California, Invoice Connection had made a practice of targeting Billtrust's customers, often offering drastically lower prices. It could afford to do so because Pinnacle treated Invoice Connection as a loss leader designed to drive business to the parent company and another affiliated business, says Beutler.

Eventually, the rivalry grew personal. "We would do anything to take a sale from him," Beutler says--in some cases offering Billtrust clients one year free on a three-year contract in exchange for switching. "I like to have an enemy," Beutler says. "It's good for rallying the troops and getting the competitive juices flowing."

2. The Problem

A less than ethical organization?

Lane agreed with his banker that acquiring Invoice Connection made business sense. But he wondered whether he could trust Beutler. Lane wanted just one thing from his rival: its customer base. What if the client list was not as solid as he had been led to believe? After all, Invoice Connection's constant attacks and lowball pricing had made Lane question whether the company was completely aboveboard. "We thought of it as a less than ethical organization," says Lane.

Another issue: the price tag. Most companies in the billing-services industry sell for four to six times earnings. Beutler was asking for more than that. He also sought a provision in which Billtrust would pay a financial penalty if it was unable to move all of Invoice Connection's customers onto its platform by a specified date. And although Lane believed the deal could be a winner at the right price, a stumble on his first major deal wouldn't do much to impress his investors. "Small companies have limited resources," says Chris Sugden, a Billtrust board member and a managing partner at Edison Ventures. "We asked if this was the best use of time and resources."

3. The Options

Living with imperfection

For Lane, the choice was stark: Either take Invoice Connection out by buying it or continue to fight it in the marketplace. The risks of the acquisition were real--but so was the risk of taking a pass. In fact, Beutler had told Lane that Invoice Connection was considering upping its investment in sales and marketing. Lane contacted three CEOs who had a good deal of merger experience and peppered them with questions. "I asked them whether they had done deals in which they had some discomfort with the target," he says. The best advice: Learn to accept uncertainty. "'You will never find the perfect deal,'" one CEO told him. "'You need to find the level of imperfection you can live with.'"

4. The Decision

Due diligence. And more due diligence

On June 6, 2011, after Beutler agreed to accept a lower price, the two companies signed a letter of intent for Billtrust to buy Invoice Connection. Lane--who was interested only in acquiring Beutler's customer list--sent a team to Invoice Connection's offices in Carlsbad to kick the tires. The team scrutinized communications between the company and its 75 clients--with the customer names redacted--to verify that those relationships were real. Lane ordered a background check on Beutler and contacted the owners of two companies that had been involved in merger deals with him. When Lane confessed his concerns about Beutler, one of them said he understood. "Earl is a fierce competitor," the man said, "but he never crossed the line."

Lane didn't get everything he wanted. He wanted, for example, to contact Invoice Connection's clients to assess whether they would jump ship after a change of ownership. But Beutler denied that request. "The biggest risk was that we were paying for these customers, and we didn't know if they would be with us in a year," says Lane. To hedge, he structured the deal in such a way that the total payout would be cut if Invoice Connection's customers were to leave Billtrust in the year after the acquisition closes. The deal also includes a noncompete clause preventing Beutler from reentering the business for several years.

5. The Aftermath

A long-awaited sigh of relief

The deal closed last September. So far, there have been no negative surprises. By early March, about 95 percent of Invoice Connection's customers had been moved to Billtrust's system. "It is too early to tell if it is a home run," Lane says. "But it is going as we expected."

6. The Takeaway

Emotion has a way of clouding things

Lane says the deal has taught him not to let emotion get in the way of an opportunity. He believes that if he had put his feelings aside, he might have acquired his rival a couple of years earlier. Seeing Invoice Connection as the enemy, he says, "clouded things." These days, he even considers his former nemesis--who remains chairman of Pinnacle and recently founded another software firm--a friend. "I like him," says Lane. "He doesn't run a company the way I do, but I have a begrudging respect for him."

Expert Opinion

Not Out of the Woods yet

Just buying the customer list instead of the entire company makes sense. Putting together two organizations that hate each other never works. People have long memories. After all, how many Red Sox fans can become Yankees fans? But even under this approach, Lane needs to understand why those customers were with his competitor. If it's because of the competitor's lower prices, by raising prices, he opens the door for somebody else to come in and do exactly what that competitor did. The only way you can raise prices is if you offer those customers more services in return.

Richard Heckmann | CEO Heckmann Corporation, Pittsburgh

Careful With the NonCompetes

If the goal is to eliminate a thorn-in-the-side competitor and gain market share by assuming its customers, it is critical that Billtrust obtain an enforceable noncompete agreement. But here the New Jersey buyer may be in for a rude awakening because in some states--including California, where Invoice Connection is located--a noncompete covers only territory where the business being sold operated and is valid only when tied to the sale of a business. So, since Billtrust did not buy all or substantially all of the securities or assets of the seller, the noncompete may not stand up in court. In that case, the value of the acquisition could literally evaporate as the customer contracts expire, because the seller could turn around and go into competition with the buyer all over again.

Lloyd Greif | Founder & CEO Greif & Co., Los Angeles

Talk to Clients--By Any Means Possible

Even if there is no issue of mistrust, companies pursuing acquisitions need to do more than scrub the numbers--they need to call the seller's customer base. As Billtrust found, it's common for the seller to say no to that. But that can be managed. The buyer can contract with a third party to contact customers--phone is better than mail--to find out what they think of the company. The results are then shared with the seller. The information can help the buyer gain confidence that the revenue base is intact. And it can also give the buyer ideas of things it might want to do postclosing.

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