Two Longstanding Independent Distributors Find Common Ground

By Matthew L. Caras

One of the most interesting and exciting transactions of the past year was the merger of two longstanding, independent industrial gas and welding supply distributors: Arcet Equipment Co. of Richmond, Virginia and Machine & Welding Supply Co. of Dunn, North Carolina. Effective October 1, 2013, their merger formed a new company named Arc3 Gases, Inc. The two businesses brought together by this merger operate 46 retail locations in North Carolina, South Carolina, and Virginia, as well as a significant beverage CO2 business serving the eastern United States from Delaware to Florida.

What makes this transaction stand out is that, unlike the acquisitions that occur on a regular basis in the industry, it is a true 50/50 merger of equals. The balanced structure of the merger ensures that the family ownership and management heritage of Arcet, on the one hand, and Machine & Welding, on the other, is maintained, while at the same time positioning the combined businesses to build upon their shared market position.

Prior to the merger, the Ellen and Dillard families owned Arcet, which was founded in 1946; and Machine & Welding, which was founded in 1925, was owned by the Aldredge family. Now the three families own the merged businesses. The energy of the merger was apparent in the joint statement issued by the Co-Chairmen of the Board of Directors of Arc3 Gases, Parker Dillard and Emmett Aldredge, Jr.: “The remarkably similar company cultures, our contiguous geographies, our wonderful employees and our shared commitment to taking care of customers all made this a once-in-a-lifetime opportunity.” Needless to say, maintaining the legacy of family ownership and management was a major objective in the merger. Fueling the merger was a fierce desire on the part of Arcet and Machine & Welding to remain independent and to become stronger and better positioned to grow both organically and through acquisition.

A merger is distinguished from an acquisition in that in a merger the owners of each company have a substantial equity interest in the merged entity (let’s call it “MergeCo”), and the owners of each company have a meaningful say in decisions made by MergeCo. In a true merger of equals between two privately owned companies, the owners of each company usually have equal, or roughly equal, ownership of MergeCo. This is so notwithstanding the relative value of each company prior to the merger. To achieve equality in the equity allocation, the difference in the relative value of the companies can be reconciled through a “true-up” involving cash, debt, assets, or other consideration at closing.

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Given the acknowledged benefits of a merger for two privately owned companies, why are mergers so rare? Why is it that the owners of small companies rarely consider a merger as a business strategy? One of the main reasons is that the threshold issues that arise in connection with the consideration of a merger are overwhelming to most small business owners. Who will control MergeCo, and how will decisions be made? Who will manage it on a day-to-day basis? How will equity in MergeCo be allocated? Will the cultures of the two companies be compatible? How will owners exit MergeCo in the future? If family-owned companies are involved, how will future generations be treated?

Another reason that the owners of small businesses rarely consider merger transactions is that the best targets are often competitors, so they are concerned that the initiation of the discussion will be perceived as a weakness or a signal that the company has a problem, or they are concerned about sharing confidential information.

Interestingly, another common concern is that the merger discussion could become tense and possibly adversarial, and the respective ownership groups don’t want to risk damage to their longstanding and important business and social relationships. And, of course, there are business owners who think that no business can run as well as they run their own business, and thus the notion of merger as a business strategy is dismissed.

In our mergers and acquisitions advisory services business, we encourage business owners to consider merger as a business strategy: a merger can provide growth opportunities and stability. We often quote Angus S. King, Jr., Maine’s independent US Senator and a member of our firm from 2003 until he was elected in 2012, who...
stated that one of the major reasons he wanted to join our firm was that he wanted “to help small businesses when they come to the classic fork in the road — where they need to sell the business or expand — and be certain that they consider growth through merger and acquisition as a viable and potentially rewarding strategy.”

Interestingly, while we usually advise companies in our role as their M&A advisor, it is clear that we can sometimes provide more value if we serve in a neutral capacity in connection with a business owner’s consideration of a transaction. As a neutral, relying heavily on our transactional experience, we are able to create a process for addressing the threshold issues, and then successive issues on a step-by-step basis, in a fashion that is manageable and low risk for the parties to the transaction. We can focus the owners of each business on their respective interests — so that each owner’s objectives, rather than staked out positions, become the subject of the discussion. It’s remarkable how often objectives can be achieved when parties are candid about their interests. And it’s amazing how often interests dovetail.

In the context of the merger of two small, privately-owned companies, a neutral has the ability to do what a representative or advocate for one company or the other cannot do: facilitating — and improving — the negotiation by continuing to keep the discussion focused on the important issues; preventing focus on an individual who is perceived as being unreasonable; providing options and alternatives; ensuring that decision-making is informed; intervening to preemptively prevent anyone from becoming adversarial; ensuring that the term, “deal breaker,” is not in anyone’s vocabulary; ensuring that lines are not drawn in the sand by keeping every door open; reducing escalation and eliminating ego as a factor in the discussion; providing insulation for the owners; and providing the ability for each company to “caucus” on a confidential basis with the neutral to review options and test ideas outside the presence of the other company.

The October 2013 merger of Arcet and Machine & Welding — a true merger of equals between two strong, family-owned, independent industrial gas and welding supply distributors — was a landmark moment. The patience, perseverance, creativity, and vision of the owners of these formidable businesses set the example for all that no strategy for improving your business is unattainable.

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