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Mergers and acquisitions carry some risks but offer big payoffs

Merger mania is sweeping Wall Street with \$3 trillion in deals so far in 2006, many affecting local companies (e.g., Clear Channel, Four Seasons, Cafe Partners Hawaii) and helping to drive the Dow and S&P 500 to record highs.

Should Hawaii business owners join the fray, and if so, how?

While the development of a mergers and acquisitions strategy is a complex task, the benefits can be extraordinary. Many of the most vexing problems facing Hawaii business owners — in-

creased competition, escalating costs, personnel shortages, limited growth/investment opportunities, and even owner "burnout" — can be addressed with a carefully designed and executed M&A strategy.



STEVE ABDALLA
ACQUISITION STRATEGIES

In highly consolidated industries, it is usually much less expensive to buy out competitors than to compete against them,

and only antitrust regulations prevent participants from merging into one entity that can exact monopoly profits. The more limited the competition in your market, the greater the impact mergers will have on your ability to raise your prices and profits.

Mergers can simultaneously reduce costs through integration of operations and economies of scale, such as the integration of two call centers into one or enabling of container load purchases.

Integration savings helped Central Pacific Bank nearly double its earnings in 2005 after its merger with City Bank. For smaller businesses, especially in Hawaii, this rarely means layoffs but rather a reduction in unfilled positions and increased ability to grow.

With 2.1 percent local unemployment, it might take 10 years to recruit and develop the number of quality employees that can be acquired in one deal.

A primary driver of the M&A boom is declining returns in other investments, as a flood of investment capital drives up asset prices. One example: cap rates (returns) on commercial real estate have dropped to as low as 5 percent or 6 percent in Hawaii. By comparison, M&A returns can be off the charts. One client of ours has acquired three separate companies, each of which returned the capital invested in six to 24 months.

Ten keys to mergers and acquisitions

- Create detailed strategic and M&A plans with clear objectives.
- Elevate M&A to a critical priority.
- Retain M&A-experienced professionals.
- Conduct a comprehensive search.
- Assess deals based on value created.
- Insist on a cultural/personal fit.
- Seek win/win deals.
- Be thorough in due diligence.
- Integrate systems carefully.
- Pay special attention to the people involved.

SOURCE: STEVE ABDALLA

Business owners need to compare the rate of return on investment in "organic" growth vehicles such as sales, marketing and recruiting to the ROI of growth through acquisition, but very few even consider the latter. Some local visionaries who did were the founders of Coldwell Banker Pacific Properties, created from the merger of four of Hawaii's top five real estate firms in 1995. Coldwell still leads the market 11 years later.

The last thing many business owners want is more growth or employees — they may be burned out, or seeking less stress and more time with family. One option is to sell, but often the price the business will fetch is insufficient to retire, and an adequate replacement income and/or career are not available.

A merger or sale of part of the company may be a viable strategy, allowing the seller to take cash out, retain some income and reduce responsibilities and stress. The big downside is that the acquirer invariably will insist on majority control.

Growth, or exit, through mergers and acquisitions is no panacea, and carries risks proportionate to the rewards. While many leading global companies, including GE, Cisco and Bank of America, have been built largely on successful acquisitions, others have been nearly undone by them (AOL/Time Warner and Daimler Benz-Chrysler come to mind). Many mergers fail, due to lack of real synergies, integration difficulties or culture clashes.

The development and execution of a successful M&A strategy requires exceptional resources, skill and focus.

STEVE ABDALLA is president of the Hawaii office of VR Business Brokers. Reach him at steveabdalla@vrhi.com.

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