Turning Managers Into Takeover Artists

How Conglomerate ITW Mints New Deal Makers To Fuel Its Expansion

By Ilan Brat
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(See Corrections & Amplifications item below.)

Last July, Illinois Tool Works Inc. bought Bagco Inc., a maker of reclosable plastic bags in Kennesaw, Ga., for about $20 million. It was ITW's 24th acquisition in 2006. But it was John Stevens's first, ever.

John Stevens

Mr. Stevens, a 43-year-old mechanical engineer with a soft Southern drawl, has spent most of his career in the gritty world of plastics manufacturing. Now, as his fast-growing company faces ever more pressure to acquire, he's become one of the newest foot soldiers in its expanding takeover army.

Many nights, the onetime plant manager sits at his dining room table in New Braunfels, Texas, drinking Diet Dr Pepper and poring over financial statements of potential targets around the world. He has learned the rules for haggling in China. He no longer feels "like a horse with blinders on," he says, never seeing his business's big picture. Now, he says, "I feel like my head's on more of a swivel, looking in all directions."

ITW, based in Glenview, Ill., has been acquiring companies nearly nonstop for 25 years, and its business model depends on its blistering purchasing pace. The conglomerate, which started as a toolmaker, has nearly tripled its size in the past decade to 750 business units world-wide. Its stock has far outperformed the S&P 500 during that time and its annual revenue has reached $14 billion.

Most of ITW's acquisitions are small, low-margin and industrial. Among its products are screws, auto parts, deli slicers and the plastic rings that hold together soft-drink cans, as

well as devices to vary the speed of windshield wipers and to measure the breaking point of toothbrushes. ITW boosts its bottom line by remaking the profit margins of each company it buys -- focusing narrowly on its most lucrative products and customers, in an unusually strict application of a business-school concept known as 80/20. In the past two decades, the company's earnings have grown at a compound annual rate of 16.6%.

A Slump

But around 2001, this little-known takeover machine hit a slump. Potential targets were valuing themselves highly despite a recession, and then the rise of private-equity firms trolling for acquisitions drove prices higher. ITW couldn't find enough companies to buy at a price it wanted to pay. The conglomerate had never had a mergers and acquisitions department, instead counting on its executives and other managers to initiate deal making. Now it decided to decentralize further -- by turning hundreds more managers like Mr. Stevens into takeover specialists.

David Speer

"We weren't necessarily banging on doors as we should have," says David Speer, then president and now CEO and chairman. "It was a question of getting people trained and re-energized." The company's goal is to have more than 1,000 business units in the next four to five years, with 50% of their sales overseas, up from 40% today.

ITW is "probably the single best company in the world at optimizing small manufacturing operations," says Robert McCarthy, an analyst with Robert W. Baird who has covered the company since 1990. But "part of the story today is, 'What have you done for me lately?' " He says the company may one day need to split itself up to keep growing.

That's what conglomerate Tyco International Ltd. is doing after buying hundreds of companies over several years. Tyco's spree ended with the company admitting

accounting lapses that magnified its earnings and declaring a whopping $9.18 billion loss in fiscal 2002.

Stoking growth through serial takeovers can turn perilous when attractive prey become scarce. Unless the revenue of each acquisition also rises, growing by acquisition may not be sustainable. Steven Kaplan, a professor of finance at the University of Chicago, said ITW is known for its ability to integrate new purchases, but adds, "At what point do you get too big to do that successfully?”

ITW officials and some analysts who follow them say the company is insulated from those risks because most of its purchases are small, at under $100 million; cheap, at 1.1 times annual earnings or less; and complement its existing business.

"People used to always chide us for not being like Tyco ... 'You need to acquire faster,' 'You need to make bigger deals,' " John Brooklier, ITW's vice president of investor relations, said by email. "After Tyco blew up, many investors told us 'thank goodness' you didn't listen to us and stuck to your long-term operating model ... .”

Two years ago, top ITW executives began giving two-day acquisition workshops at headquarters for business-unit managers. So far about 160 people, with backgrounds in everything from production lines to sales, have been trained. Last year, the company emerged from a period of relatively flat acquisition activity to establish a new record for the firm: 53 purchases, with a combined value of about $1.7 billion.

Doug Marciniak, who joined ITW as an internal auditor at its headquarters in 1984 and now manages an auto-parts maker, went through the training last February. Months later, he negotiated the purchase of a Korean automotive supplier, fielding evening conference calls to hammer out the deal in his basement home office lined with autographed Chicago Cubs bats and balls.

Mike Zimmerman was in sales and marketing before he was promoted to manage an ITW company that makes chemicals for the automotive industry. Also trained last February, Mr. Zimmerman spends at least half a day each week pitching business owners on deals, though none have developed yet. "You cannot be shy about this," he

says. In his opening pitch he tells prospective targets: "We're ITW. We make acquisitions."

Unusual Beginnings

ITW had unusual beginnings. In 1912, four businessmen were brought together by a newspaper advertisement taken out by a Chicago financier. He wanted to invest in a manufacturing company and eventually install his son as president. The venture first made metal-cutting tools, but over the years ITW expanded into truck transmissions and pumps, filters, fasteners for the construction industry, plastics, electric switches and other industrial components. In the 1960s, one of its engineers developed a plastic ring carrier for beverage six-packs.

By 1982 ITW, which then ran about 40 business units, saw its margins squeezed amid a retrenching in the U.S. auto industry and increasingly stiff competition from Japanese manufacturers. John Nichols, then the new CEO, ramped up acquisitions and gradually turned to the 80/20 strategy. The concept derives from the Pareto Principle, named for a 19th-century Italian economist who observed that 20% of Italy's population earned 80% of the income. For ITW, it means focusing on the 20% or so of products and customers that can generate 80% of a business unit's revenues.

ITW first applied the idea to some of its assembly plants, where production lines had to frequently be reset to make a wide variety of products, losing time and money. The company simplified the product lines to concentrate on the most important items. That worked so well that Mr. Nichols had other departments apply the principle, says James Farrell, who took over from Mr. Nichols as chief executive in 1995.

The concept now is so integral to ITW's business model that its managers use "80/20" as a verb. When ITW acquires a company and revamps it along 80/20 lines, it often shrinks revenue initially but typically doubles its profit margin in three to five years. Over time, the company often reduces staff at its acquisitions by about 5% to 10%, it says.

"We say around here, complexity creates chaos, 80/20 creates focus," Mr. Speer says. "We tell our acquisitions ... we expect you're going to shrink before you grow.”

Mr. Stevens's unaccustomed role has meant many added business trips and led him to delegate more of the running of his business units to subordinates -- at least one of whom now also has been trained to do acquisitions. But he sees the shift as natural for someone used to negotiating prices and contracts as part of running a business. "A lot of times, it's no different than negotiating a price increase with a customer," Mr. Stevens says.

Entrepreneurial Streak

His new focus allows him to rediscover an entrepreneurial streak he first showed as a boy growing up in Knoxville, Tenn. At 12, he had a job selling University of Tennessee football programs. Competition at the stadium made it tough. So he walked a mile and a half up the street to a traffic light, where he caught motorists looking for something to read as they waited in traffic to park. "I remember how that excited me, how you could beat the competition," he says.

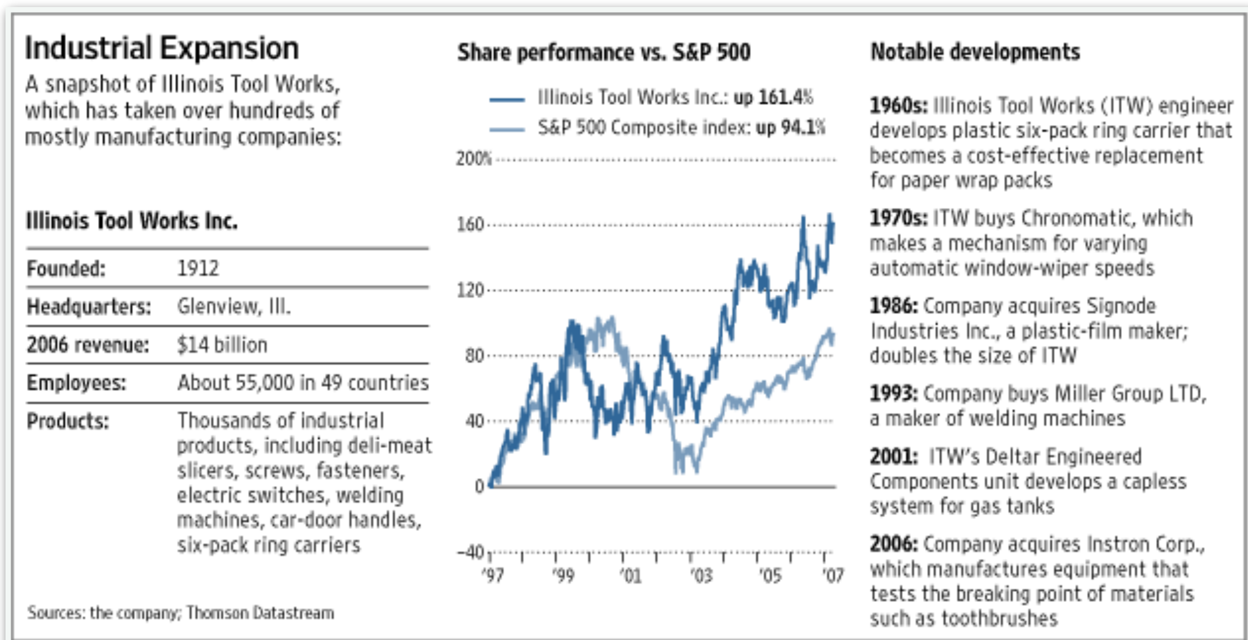
Mr. Stevens joined ITW in 1997 as the operations manager for its Minigrip business, a maker of resealable plastic bags based in Seguin, Texas, northeast of San Antonio. In his job interview, Mr. Stevens suggested reconfiguring the assembly machines so that bags could be made and packaged in fewer steps. He got the job and soon made over the plant so that a single manager, instead of three, could oversee the whole process.

In 2004, Mr. Stevens was promoted to general manager. That summer, he wrote a long-range plan that listed four companies he wanted to snag. Bagco, a strong Minigrip competitor that outsourced its manufacturing to Thailand, was second on the list. In April 2005, Mr. Stevens was copied in on a five-page letter Mr. Speer sent to top managers emphasizing the importance of acquisitions, Mr. Stevens recalls. "When I

was copied on that letter, I interpreted that to say, 'This means you now, John,' " he says.

In late 2005 Mr. Stevens heard that Bagco's owner, Nossi Taheri, was looking to sell. Mr. Stevens invited Mr. Taheri to fly from his Georgia headquarters to San Antonio to meet, figuring that if the owner took the trouble to travel he would be ready to deal. With his boss, Jim Kohl, Mr. Stevens initially met with Mr. Taheri for two hours, and over the next three months, there were weekly conference calls. Mr. Taheri didn't respond to requests to be interviewed for this story.

Mr. Stevens worried about the deal as he headed into ITW's two-day acquisition workshop in early February 2006. There, a parade of top ITW managers made PowerPoint presentations on identifying and wooing potential targets, appraising a business and implementing the 80/20 process.



Mr. Stevens took 20 pages of notes in a composition notebook. He learned, for instance, that it's better to walk away than end up with a bad deal. "With a machine, you know what you're getting into," he says. "When you buy [a company], you really don't know it till you buy it."

Finally, the bargaining with Bagco over its price ended after ITW sweetened the deal with a six-month consulting fee for the owner, says Mr. Stevens. ITW wouldn't disclose

the purchase price but says it was in line with Bagco's average annual revenue, which was about $20 million.

After the deal closed in July, Mr. Stevens faced his new employees, who numbered about 20. The acquisition workshop had prepared him with do's and don'ts for his opening speech. He set up a projector to show an image of the company logos merging, and stressed the benefits of the takeover. The room was quiet, he recalls. He promised to meet with each Bagco employee to hear their concerns.

Since then, Mr. Stevens often has been on the road for 10 to 12 days at a time. On trips, he spends hours at night with his laptop scouring Web sites for information about takeover prospects. He laments time away from his three daughters and frequently missing Sunday church services with his wife, Sandra.

Paying Off

But it also has paid off. Late last year he was promoted again, to a group vice president overseeing four units. He is now spending more time seeking acquisitions, especially among plastic-bag makers. He recently negotiated to buy another bag maker, which ITW would not name, in southern China. To prepare, he read the Harvard Business Review's book on doing business in China, which noted that haggling is part of Chinese culture.

After four trips to China in six months, sometimes alongside a company acquisition specialist, he sat down alone early last month with the business owner and an interpreter to hammer out final details in a conference room overlooking a dirt field. After half a day of talks, Mr. Stevens says he abruptly pushed back his chair and started to pack up his things. The owner asked if he was angry. Mr. Stevens says he firmly but politely said he didn't think ITW corporate managers would approve the owner's requests.

The owner handed Mr. Stevens a whiteboard marker and told him to draft a proposal that would get the deal done. The owner took a picture of it with a digital camera and emailed it to Mr. Stevens so ITW could use it to draft a letter of intent. Nine days later, Mr. Stevens learned the Chinese company had accepted.

—Gary Putka contributed to this article.

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Corrections & Amplifications:

Illinois Tool Works generally pays 1.1 or less times annual revenue for its acquisitions. This article incorrectly says the company pays 1.1 or less times annual earnings.

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