



SIZING UP
M&A
VALUE
NOW

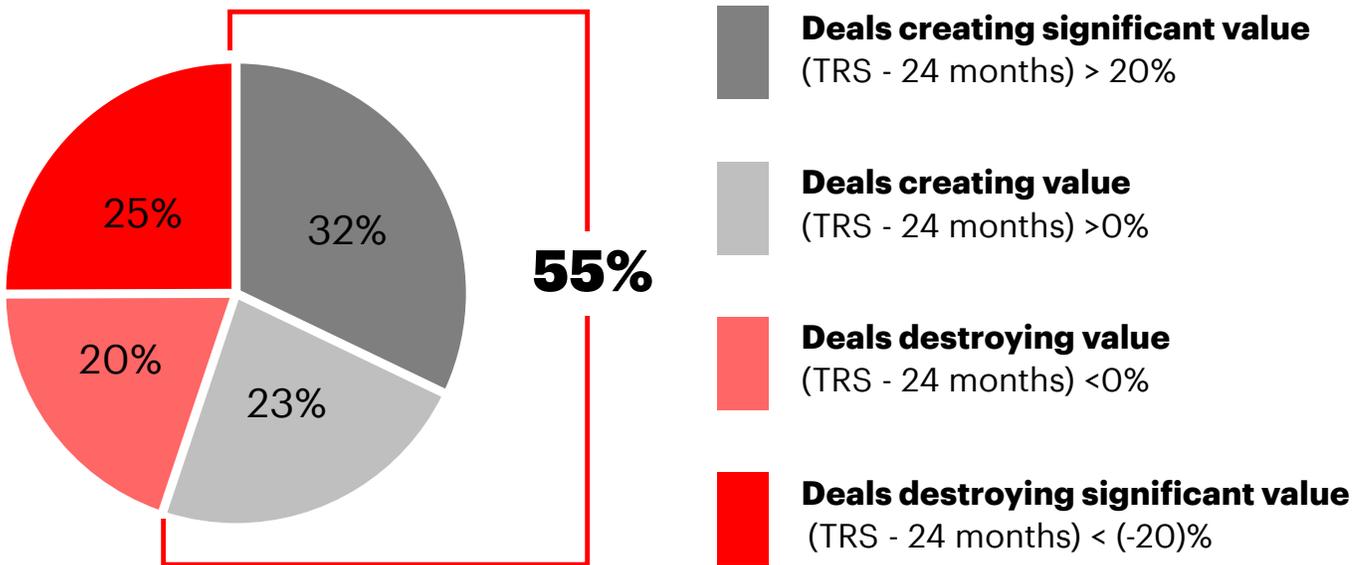
Mergers and acquisitions (M&A) activity remains a hot topic for many companies serious about growth. In fact, there's ample evidence that the 2017 global M&A market is as healthy and robust as it's been in a decade. But is the renewed health of the M&A market just setting up acquirers for failure? It is if you believe in the conventional wisdom that M&A typically doesn't create value—which has been proven to be false.

According to Accenture Strategy research, large acquisitions have a more than fair chance of creating value for the acquirer's shareholders. When analyzing the 500 largest acquisitions by publicly traded companies announced between January 2004 and March 2014, we found 55 percent of them created value 24 months after the deal was announced.¹ To what can we attribute the success of these deals? Three factors stand out: digital disruption, the macroeconomic cycle, and transaction size.

FIGURE 1
Value creation from M&A

Total return to shareholders (TRS) above industry index for top 500 deals

By number of deals (24-month TRS vs. industry index)



Results through December 2015 for the top 500 deals by value announced from January 2004 through March 2014.

Source: Accenture Strategy analysis.

FOCUSING **ON DIGITAL**

Companies in all industries recognize they need vital digital capabilities to compete. And increasingly, they're looking to M&A as a way to get them quickly. In fact, in industries such as banking and communications, digital disruption is driving the M&A agenda—and those deals are paying off.

According to Accenture Strategy research, M&A in industries being most disrupted by digital tend to create more value than those in less-disrupted industries. For instance, according to Accenture Strategy analysis, median M&A Total Return to Shareholders (TRS) is highest in industries that are experiencing technological change and convergence—such as banking (27 percent) and communications (11 percent), which include landmark Bank of America/MBNA and NBC/Comcast deals. It's lowest in oil, gas and utilities (-5 percent) and media and entertainment (-10 percent), where deals—such as Fortis/UNS Energy and XM/Sirius—struggled to manage a return.

Why the disparity? Companies in the former group are taking an acquisition's disruptive technology or digitally enabled business model and scaling it across the acquirer's business—thus, compounding the positive impact. Conversely, the latter tend to focus more on acquiring hard assets to drive scale, especially from a geographic standpoint.

To be sure, horizontal acquisitions that double-down on existing platforms and industry definitions remain a staple of the M&A landscape. But more often, the most successful acquirers are using M&A to fundamentally reshape their competitive stance (and, often, the boundaries of their industries) by acquiring critical digital capabilities they lack. The goal: to get closer to their customers, understand their desires and behaviors more accurately, and introduce new products and services more quickly. While there always will be deals done purely for scale, the ones generating the outsized returns that really get shareholders excited are those that bring to the acquiring company new technology, the prospect of new products and services, and new markets and customers.

TIMING **IS** **EVERYTHING**

Accenture Strategy research found that the timing of an acquisition is the most reliable predictor of its success in creating shareholder value (Figure 2 on the next page). Importantly, that time is now.

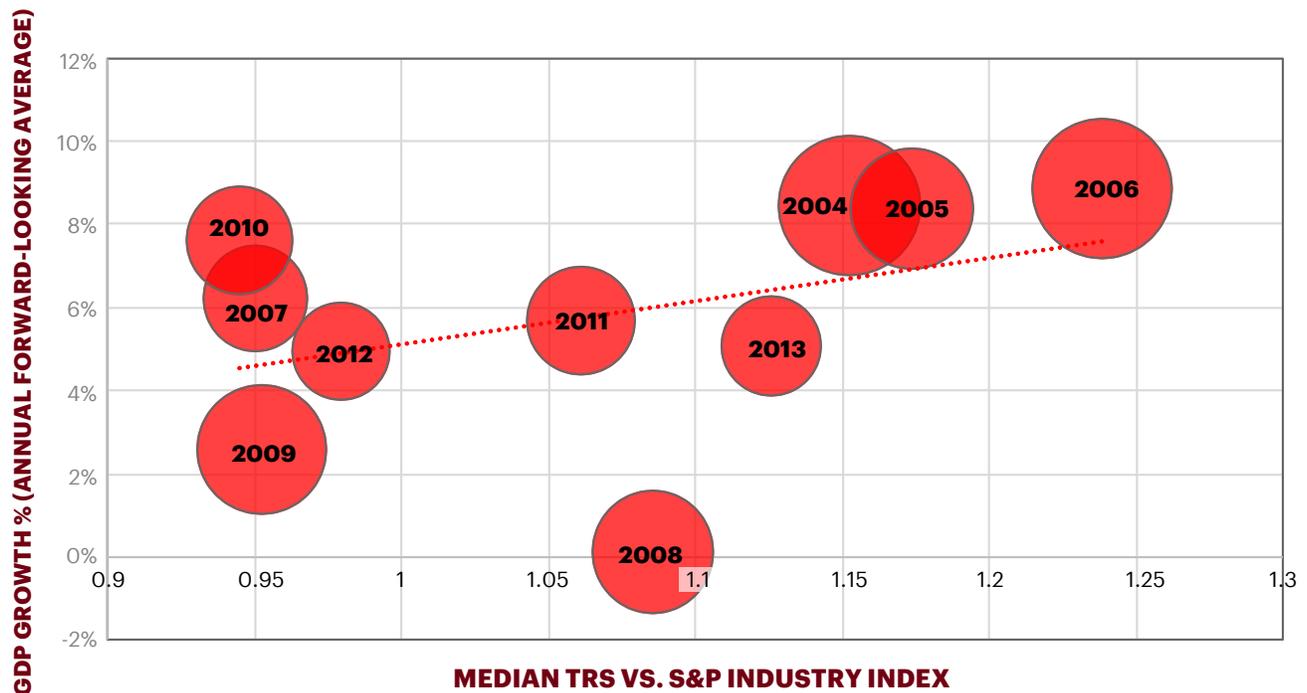
An acquisition is a bet on the health of the macroeconomy. Without an environment for growth, there's little prospect for value creation for the acquirer's shareholders. That's because the value of a transaction's anticipated cost synergies are often paid to the target's shareholders in the form of an "acquisition premium" to get the target's shareholders to approve the acquisition. By pursuing deals during an upswing, a company benefits from growing revenues, markets and profits, which offer the potential for greater returns than during a down economic cycle, when revenues and profits are flat and prospects for growth are dim.

This is borne out in our research: Deals announced during the upswing of the macroeconomic cycle—which is where we are today—averaged 13 percent to 15 percent return compared with deals announced during the trough, which averaged -5 percent to 6 percent.

M&A is a bold play for growth and as such is best pursued when a company is bullish on the future.

FIGURE 2
Deal timing is the most reliable predictor of value

Deals announced in the “economic bubble” years of 2004-2006 created significantly more shareholder value than those announced at the 2007 peak of the cycle and in the 2008-2010 slide into the Great Recession.



Year on the graph refers to the year of commencement of the deal. Size of the bubble represents average deal size in \$ MN. Top 500 deals from 2004-2014 with results through December 2015 have been considered for this analysis. Global GDP data compiled from IMF reports.

Source: Accenture Strategy analysis.

THERE'S A **SWEET SPOT** **FOR VALUE IN DEAL SIZE**

A third reliable indicator of success is deal size (Figure 3 on the next page). While smaller acquisitions may be easier to execute and integrate, they often don't materially move the needle on revenue, generate many cost synergies, or leverage the acquirer's full financial and organizational capacity.

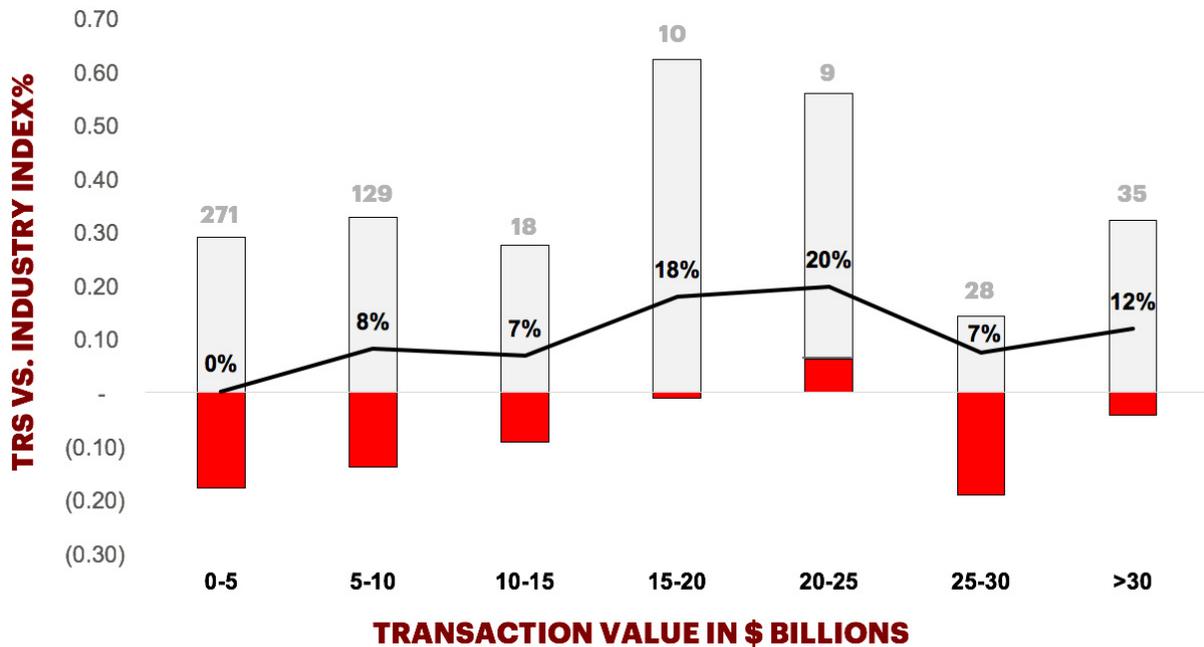
Small acquisitions are like a football team in the English Premier League (EPL) playing a match against a team from the second division. It's very likely the EPL squad will win, but it won't gain much respect from the public for doing so. It won't have generated much of a return from its highly compensated star players (many of whom probably will sit out the match on the sidelines, never taking off their warm-ups). And it will have lost an opportunity to deploy those star players against a more worthy opponent.

So it is with acquisitions that are too small. Sure, they likely will create some value because they're relatively easier to execute and integrate. But they leave opportunity on the table because they don't leverage the full power of the acquirer's balance sheet or its organization's full talent and energy. Not surprisingly, although most smaller deals we studied had positive returns, many of them didn't create appreciable value: Deals of less than \$15 billion returned between 0 percent and 7 percent.

FIGURE 3
Bigger deals drive higher value

Median return by deal size

Deal size in US\$ billions and 24-month TRS vs. industry index



RANGE OF RETURNS: ■ Percentile 25th □ Percentile 75th — Median TRS %
TOTAL NUMBER OF DEALS: IN LIGHT GREY

Source: Accenture Strategy analysis.

At the other end of the spectrum, the very largest acquisitions with transaction values greater than \$25 billion, the returns were better, but still not great: between 7 percent and 12 percent. With these deals, complexity, regulatory reviews, inevitable delays in closing, and greater integration risk begin to whittle away the returns.

Between these poles is where M&A returns are the highest. We found deals between \$15 billion and \$20 billion returned 18 percent, while those between \$20 billion and \$25 billion did even better, with 20 percent. Deals in this sweet spot are most successful because they strike the right balance between using a company’s capital and talent most effectively, and avoiding the factors inherent in the mega-deals that can make them difficult to pull off and integrate well.

MOVING **FORWARD** **WITH M&A**

M&A can improve a company's financial and competitive position. Thus, it should be a favored tool for any company serious about maximizing returns to its shareholders. But M&A success is not a given—various factors can influence the results. To enhance their chances of generating the greatest returns, acquisitive companies should keep three keys in mind when considering their next moves.

GO DIGITAL

Companies should seek acquisition targets that would benefit from or are already introducing digital disruption into their industries. Microsoft is a good example. The tech giant has executed multiple deals to bolster its social media and social networking platforms, an acknowledged gap in the company's offerings. These include its acquisitions of Skype in 2011 (\$8.5 billion), the social media company Yammer in 2012 (\$1.2 billion), and LinkedIn in 2016 (\$26 billion), which enabled Microsoft to add unique technology innovations to its portfolio. But the company also benefited from large synergies by integrating the acquisitions' technology with Microsoft's bread and butter, its Microsoft suite (SharePoint, Skype and Office 365).²

To be sure, asset-intensive “like acquiring like” horizontal acquisitions, such as AB InBev/SAB Miller, still abound. With increasing frequency, however, companies in asset-heavy industries are looking for disruptive digital technologies or capabilities they can scale quickly across their operations to significantly improve agility and decision making. Often these types of acquisitions are cited as examples of industry convergence.

In both cases, prospective acquirers must base their pursuits on their potential for revenue and cost synergies without being limited by traditional industry boundaries.

GO NOW

With the global economy in continued recovery, now is the time to act. Yes, there’s uncertainty in the world. But companies shouldn’t wait until they know the impacts of unexpected election results, instability in the East, and an initial rise in interest rates. By then, it could be too late to maximize returns before the next pause in macroeconomic growth inevitably hits. That’s why speeding up target screening and overall deal execution is paramount. In doing so, companies should look beyond their typical targets that represent a traditional scale play. Instead, they should more proactively explore adjacent markets or industries with targets that could add impactful customer-facing or back-office capabilities—or both.

GO BIG

Large deals move the needle much more than a string of smaller ones. To maximize value generated, companies should look more skeptically at small bolt-on deals or tuck-in acquisitions that consume precious leadership time and organizational capacity yet won't have a significant impact on their growth prospects. Instead, they should prioritize screening and due diligence for attractive targets in the sweet spot of \$15 billion to \$25 billion.

That's what Facebook did with its \$19 billion acquisition of mobile messaging app WhatsApp in 2014.³ While many were shocked by the price Facebook paid for a company that had never generated more than \$20 million in revenue, the deal offers several significant benefits for Facebook. The biggest are the growth opportunities it presents in the form of entrée into mobile messaging, one of the hottest markets Facebook has yet to penetrate—and access to hundreds of millions of users, particularly in emerging markets, where WhatsApp is the clear leader and where Facebook has struggled thus far to enter.

United Technologies is another company that bet big and won. United Technologies paid \$18.4 billion for aircraft maker Goodrich in 2011. Five years on, the deal has generated attractive returns on both the revenue and cost sides. It enabled United Technologies to take advantage of Goodrich's backlog and gain a bigger share of work on next-generation aircraft (the opportunities associated just with engine cases totaled \$12 billion) while exceeding expectations on cost synergies (which hit \$500 million at the end of 2015, a year ahead of schedule).⁴

The fact is, with the M&A market remaining hot, attractive targets likely won't remain on the market for long. Companies that want to play need to get off the sidelines and get into the game.

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NOTES

¹ Accenture Strategy M&A research of 500 largest acquisitions by publicly traded companies announced between January 2004 and March 2014.

² Ari Levy, “Microsoft fights history with biggest-ever software acquisition,” CNBC.com, June 13, 2016.

³ Adrian Stevens, “How Facebook Will Benefit from the WhatsApp Deal,” Market Realist, via Yahoo Finance, June 1, 2016.

⁴ Brooke Sutherland, “That Goodrich Deal,” Bloomberg Gadfly, November 1, 2016.

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