Driving business growth and operational excellence

Delivering automotive shareholder value through M&A

A prologue to our four-part mini-series on gaining operational synergies through M&A

Recent research by Deloitte Consulting LLP revealed M&A-related activity as a primary driver of performance and contributor to shareholder value within the global automotive supply base. Yet, automotive suppliers don't appear to be looking at M&A as a primary driver in delivering on their business objectives. Moreover, companies that do engage in M&A often miss opportunities to increase value because they fail to properly prepare, plan, and execute against the activities that result in operational excellence.

Why the paradox? And what can companies do to better prepare and execute against their M&A objectives?

To help executives think through these challenges, we have developed a series of five white papers that may help answer both the "why" and the "how" of M&A in the automotive industry.

The following serves as the prologue and seeks to answer the "why." In other white papers in the series, we tackle "how" to properly plan, prepare, and execute M&A activity in the quest to seek operational synergies and excellence.

For more information and to download the series, visit www.deloitte.com/us/maminiseries.

Introduction

According to a recent study by Deloitte Consulting LLP focused on the financial performance of 213 Tier 1 automotive suppliers from 2003-2013, those suppliers that executed M&A strategies as a core part of their growth strategies tended to deliver higher shareholder value than their peers in the study . In addition to gaining innovation benefits as a result of M&A, those top-performing automotive suppliers in that Global Automotive Supplier Study have been successful buyers, as well as portfolio managers focused on selling non-core assets – all the while assisted by a structured diligence process. These activities have often resulted in the creation of shareholder value and superior performance in a global industry comprised of hundreds of companies all vying for a competitive advantage. Those that have been most successful – the ”Top 56 Performers” – have been 65 percent more successful closing on transactions than the broader automotive supply base[1].

Given this demonstrated performance, why does another recent Deloitte Consulting LLP survey of automotive supplier executives, which was tailored off of the Global Automotive Supplier Study, show that automotive supplier executives rank M&A-related activities as only a minor contributor to shareholder value? Perhaps there is a lack of clarity and some uncertainty related to M&A and the links to shareholder value and exceptional performance. Perhaps company objectives are focused elsewhere.

Whatever the reasons may be, the Deloitte Consulting LLP analysis of a decade of financial performance identifies Diversification as one of six winning, and one of three “table stakes” themes that drive exceptional shareholder value. Within the Diversification theme, M&A was identified as a key lever used by top-performing suppliers, both alone and often when combined with other drivers of performance.

In this publication, which serves as the prologue to our miniseries on gaining operational excellence through M&A, we attempt to clarify how M&A can help drive performance and set the stage for the additional perspectives in the remaining publications in the miniseries. Those other parts of the series then delve into why companies may fail to achieve the operational synergies they strive for in their M&A efforts.

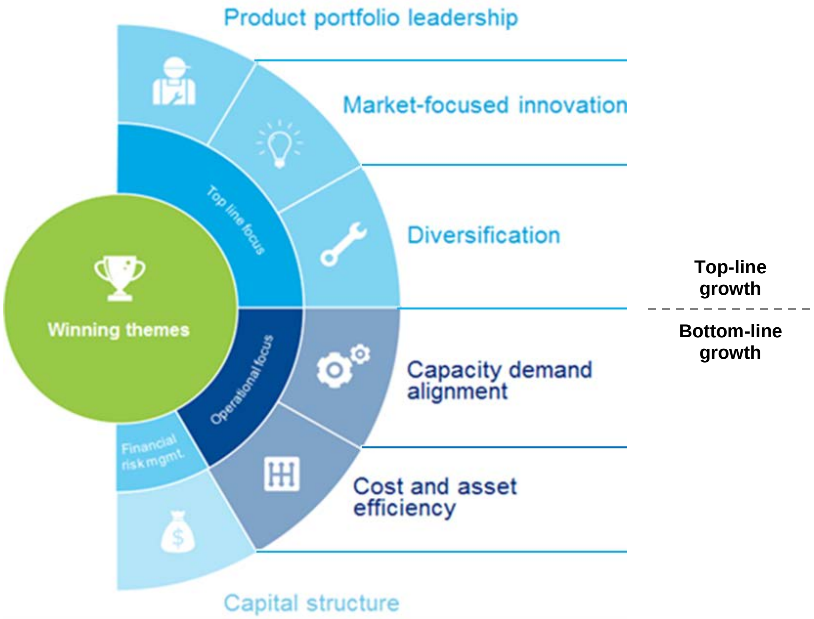
[1] S&P Capital IQ transaction summary reports by supplier

Defining success

Exploring the drivers of shareholder value in the automotive supply base

The Global Automotive Supplier Study identified 56 suppliers as top-performers based on shareholder value creation over the timeframe in-scope for the study (2003-2013). The study revealed that these "Top Performers" had outperformed the global population on key financial and operational metrics, including revenue growth, profitability, and return on assets (ROA). The study also identified six "winning themes" that consistently contributed to performance (Figure 1).

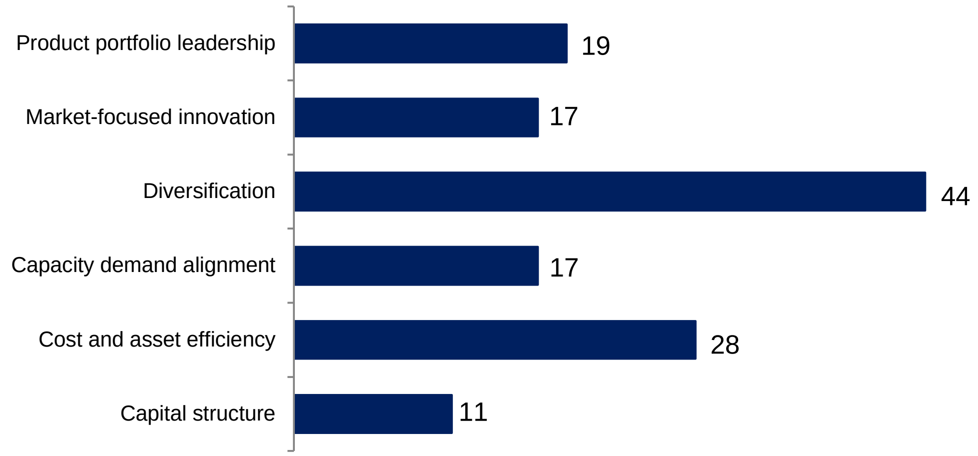
Figure 1: Winning themes that drive shareholder value



Source: Deloitte Consulting LLP 2014 Global Automotive Supplier Study

Among those six winning themes, the study also revealed that more than 75 percent of the "Top Performers" in the analysis displayed activities that would be categorized within Diversification – illustrating that of the three winning themes contributing to top-line growth, suppliers are heavily focused on executing strategies meant to diversify the business (Figure 2).

Figure 2: Top Performers' presence against winning themes



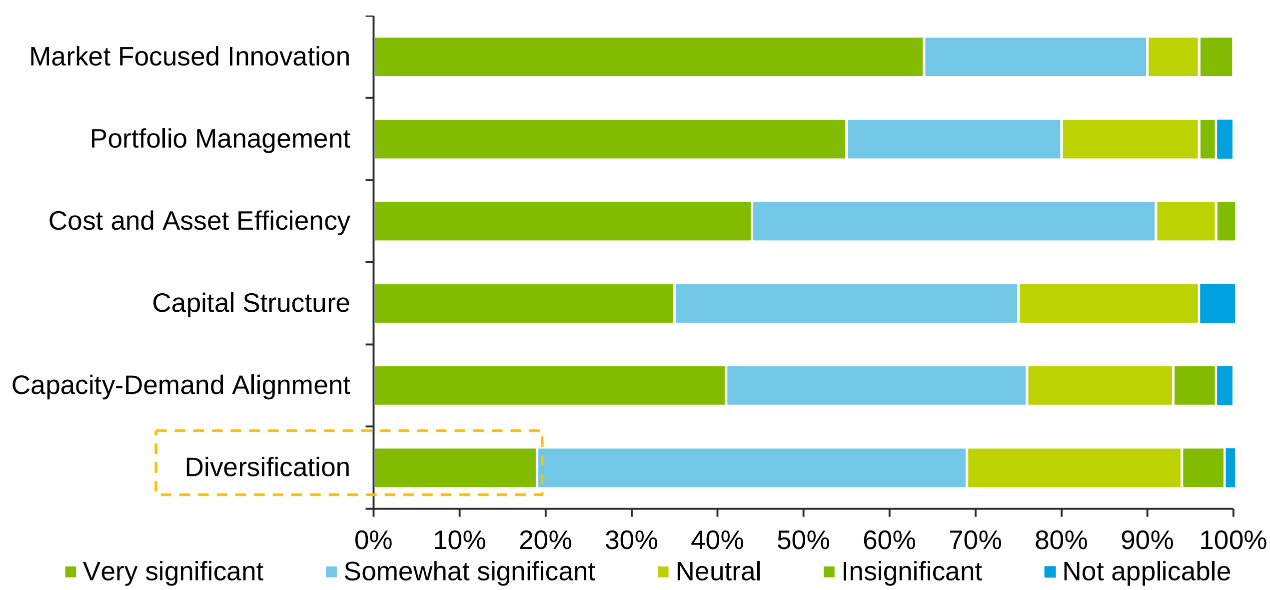
Source: Deloitte Consulting LLP 2014 Global Automotive Supplier Study

To delve beyond the financial analysis, and in conjunction with the Global Automotive Supplier Study, Deloitte Consulting LLP also collaborated with the Original Equipment Supplier Association (OESA) to field a survey of automotive supplier executives. The survey was designed to help understand suppliers' investment in the winning themes, the levers used to execute the themes, and the significance of each of the themes as they relate to their organization's enterprise performance.

The Global Automotive Supplier Study reveals that suppliers are turning to diversification more so than any other winning theme in the efforts to deliver exceptional shareholder value.

The survey of supplier executives yielded some interesting results. In contrast to the financial analysis that showed a large majority of suppliers displaying activities that would be classified as Diversification, the survey revealed that current business planning was least focused on Diversification as a driver of growth. When compared to the other winning themes within their business strategies, less than 20 percent viewed Diversification as a very significant strategy to meeting their growth objectives – *last* among the themes that executives viewed as significant (Figure 3).

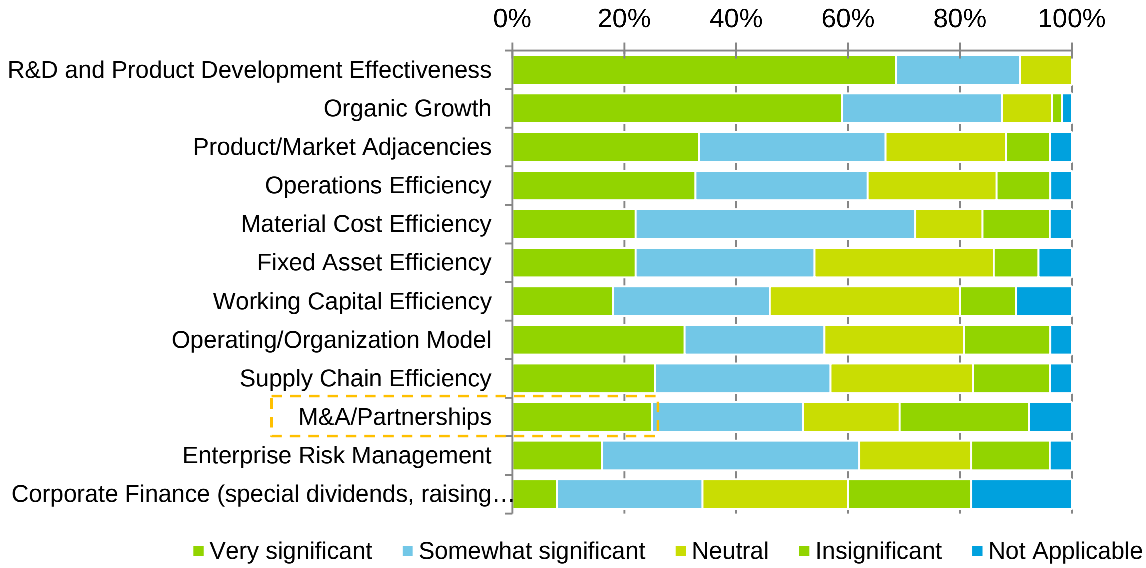
Figure 3: Supplier executive ranking of the winning themes



Source: Deloitte Consulting LLP and OESA Survey

To go even deeper and explore how suppliers are evaluating and using operational and strategic “levers” that contribute to Diversification, the Deloitte Consulting LLP – OESA survey asked executives to rank the significance of specific actions that relate to enterprise performance. Only a quarter of the executives identified M&A as very significant (Figure 4).

Figure 4: Significance of each lever used to execute Diversification as they relate to enterprise performance



Source: Deloitte Consulting LLP and OESA Survey

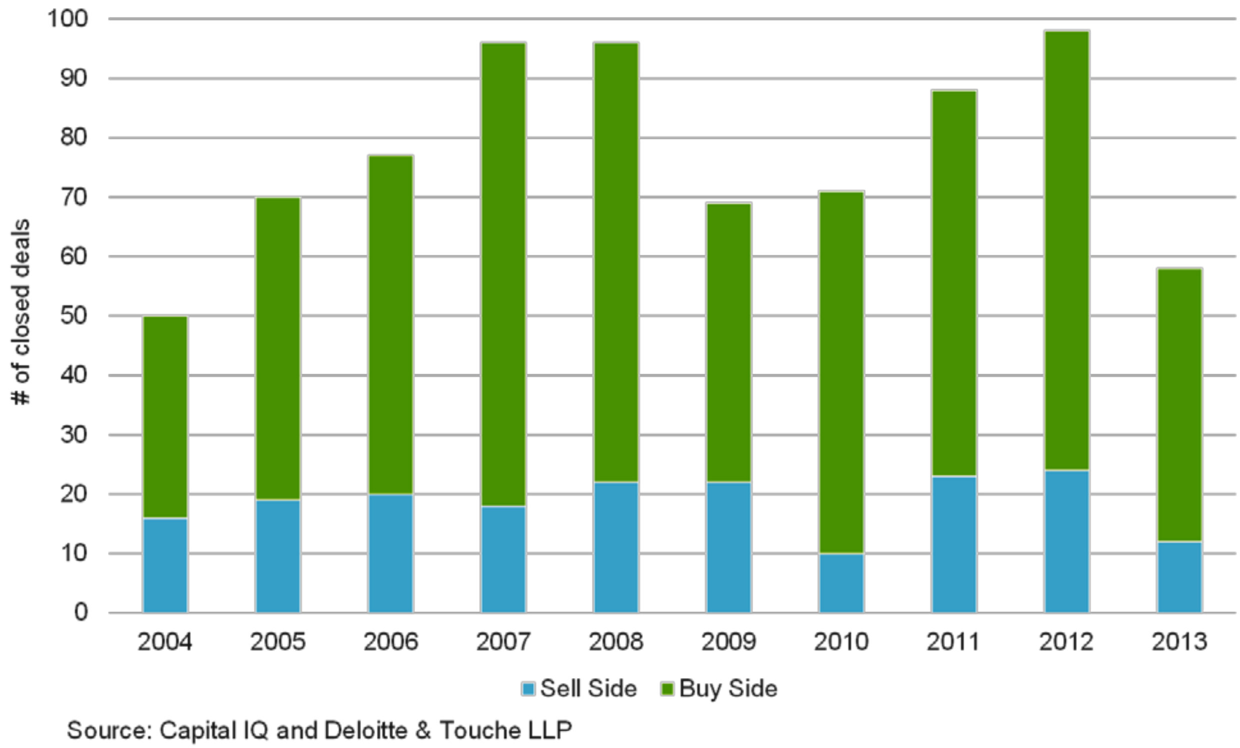
Do these results – suppliers ranking Diversification last among the six winning themes and viewing M&A as less significant among the lever that contribute to Diversification – suggest that priorities are shifting away from what has shown to be a driver of growth?

Making the case for M&A

The automotive supply base is one of the most diversified and global industries in the world. It can also be extremely volatile, as experienced during the last global recession. Now, as the global economy and the automotive industry manage through a growth cycle, the shift in investment or identification of Diversification as the least important factor for future value creation may be a mistake and may result in missed opportunity to drive growth.

M&A has played a significant role in executing diversification by expanding geographical presence into new markets, diversifying customer base / product offerings, acquiring new technologies, and driving innovation. This value appears to ring true with top performing automotive suppliers actively investing in M&A. On average, the top performing suppliers over the last decade closed over 1.4 transactions per year. Even during the economic downtown, the top performers were active participants in M&A – both from a buy and sell-side perspective. Additionally, the top performers closed transactions at a rate 65 percent higher than the more than 200 suppliers in the Global Automotive Supplier Study (Figure 5).

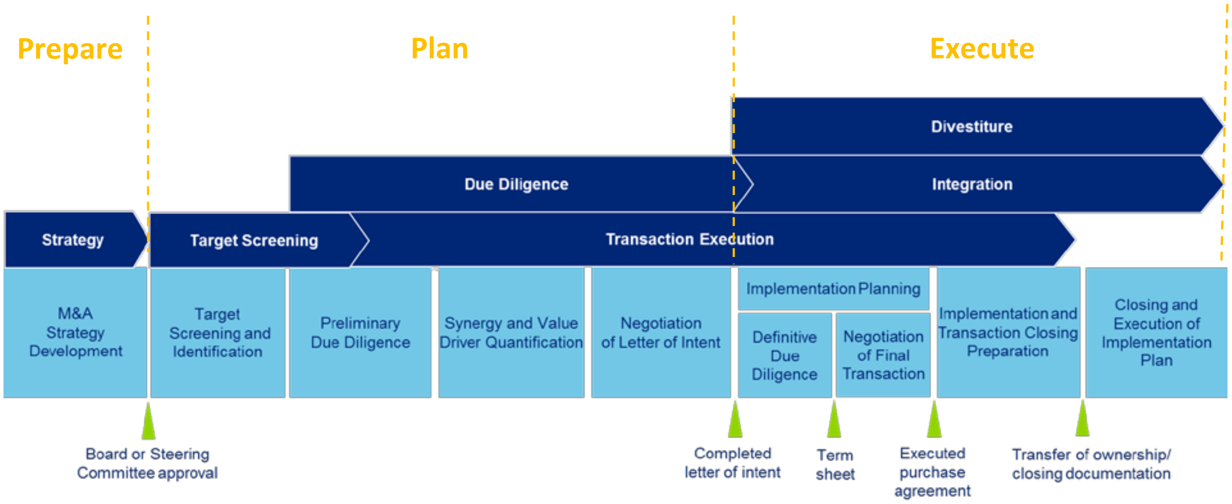
Figure 5: “Top Performers” deal activity by year



A structured process throughout the transaction lifecycle requires focus on operational excellence

While our research defines the reasons why M&A is typically a critical driver of business growth, executives should also consider how to properly prepare and plan M&A execution to increase the value of their M&A activities. We believe that a recurring, structured approach to M&A can be a key driver of successful acquisitions and divestitures (Figure 6).

Figure 6: M&A life cycle



In one example, one of the Top 56 suppliers identified in the Global Automotive Supplier Study has recognized success over the past 10 years because they have a dedicated team monitoring the M&A market, evaluating the segments of their business they wish to develop and maintaining an active acquisition target list. This same structured process follows throughout the diligence and transaction cycle, where engaging stakeholders within the organization and integrating an experienced diligence team also contributed to the company's success. In addition to their structured process and historical experience in closing deals, they have focused on pursuing deals of an appropriate size that complement their core business.

A structured process is important when rationalizing a supplier portfolio in an effort to capture the highest value possible and reduce the time to close. Seller preparation, including identifying clear stakeholder goals, performing pre-sale due diligence, and preparing a stand-alone financial statements can impact transaction values. Many companies in the industry are engaging sell-side due diligence advisers to assist sellers in this process.

The road ahead

There are a number of megatrends impacting the global automotive industry that likely will continue to influence the need for suppliers to look to M&A as a growth objective. One example is federally mandated fuel standards in the U.S. and abroad that are serving as a catalyst for automakers' continued efforts to make vehicles lighter and ultimately more fuel efficient. As a result of the requirement for Corporate Average Fuel Economy (CAFE) standards to increase over 45 percent from 2016 to 2025,[2] the automotive industry is in the process of reengineering their vehicle designs with advanced light weighting, alternative materials, and electrification. To achieve these dramatic new standards, suppliers are increasingly focusing on diversification and acquisition of new technologies and related capabilities. Based on vehicle platform cycles from development through aftermarket, there appear to be less than two cycles remaining to comply with the 2025 NHTSA standards. In this example, those suppliers operating in the powertrain and advanced materials segments that are not proactively diversifying, evaluating and developing their product offerings and technology may already be behind the curve.

While organic growth was identified as a more significant source of diversification in the Deloitte Consulting LLP – OESA survey, many suppliers are discussing growth at a pace that appears aspirational when compared to OEM global unit growth rates. Many suppliers will be opportunistic and welcome M&A opportunities, but others may be concerned about sacrificing current profitability or making mistakes of the past, including over-paying.

More deals will likely emerge as the competition for growth increases and organic or conquest options cannot keep pace to deliver growth. This is again reinforced by executive comments captured in the Deloitte Consulting LLP – OESA survey. One respondent to the survey said, "Diversification and organic growth are by far our priorities for the upcoming years. We have a high market share in our primary product, a niche item. Growth will have to come from leveraging our capabilities into adjacent markets." M&A (in addition to organic growth and internal development) may be necessary to realize these goals.

[2] Corporate Average Fuel Economy (CAFE) standards to increase over 45 percent from 2016 to 2025 – http://www.epa.gov/otaq/climate/regs-light-duty.htm#2017-2025

Conclusion

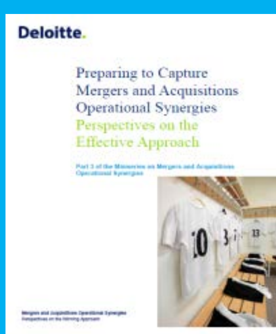
While the Deloitte Consulting LLP analysis of 10 years of financial data revealed Diversification as a critical winning theme to delivering exceptional shareholder value, the survey with OESA indicates that many executives currently appear to be more focused in other areas. This presents a paradox since the Global Automotive Supplier Study indicates that M&A should be considered as a strategic opportunity to expand suppliers' diversification, similar to the top performers over the last decade. Effective identification of targets, assessment of market conditions and consideration of the size of the transaction in comparison to their own operations by a seasoned deal team can increase the chances of completing successful transactions.

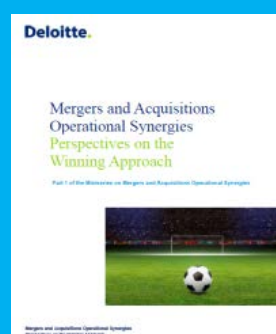
As history has demonstrated, having these core attributes in an M&A deal team, both internal and external, can deliver growth and increased shareholder value. A continued focus on acquisitions and non-core divestitures to achieve diversification, growth and long-term strategies may drive superior performance and help separate companies in a competitive industry like the automotive supply base.

And for those automakers that do engage in M&A activities, "how" to gain operational synergies once the deal closes is another opportunity for executives to increase value. To read insights on planning, preparing, and executing operational excellence through M&A, visit www.deloitte.com/us/maminiseries.

Exploring operational synergies in M&A

In our miniseries on operational synergies in M&A, we identify and discuss the three principal reasons why companies fail to achieve M&A operational, supply chain, and manufacturing operations synergies. Parts 1, 2 and 3 are now available, and Part 4 is scheduled for publication in Q4, 2014.





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