

Winning in M&A

How to become an advantaged acquirer

Mergers and acquisitions (M&A) continue to be a favored corporate development tool of executive teams, as evidenced by last year's record-setting level of deal-making. By the end of 2015, companies had spent some \$3.8 trillion on M&A—the highest amount ever—according to data compiled by Bloomberg.¹ And while M&A may not continue at this pace, the trend seems far from abating. Many companies intend to continue combining for numerous strategic reasons, including expanding in existing markets and gaining scale efficiencies, according to a recent Deloitte *CFO Signals*[™] survey (see sidebar, “Reasons to deal”).²

2015's M&A volume indicates that we may be in a “merger wave”—concentrations of accelerating M&A activity—possibly the sixth so far in the last century.³ While time will tell if we have crested the wave, this type of heated pace can trigger buyer mistakes, such as deals that don't fit strategically or achieve anticipated benefits. Moreover, premiums that acquirers agree to pay over the target's pre-bid share price tend to escalate as competition intensifies.

Amid such deal exuberance, it may benefit companies to not only become an acquirer, but to become an *advantaged acquirer*. Several factors that have been driving M&A for the last few years—low interest rates, accessible and inexpensive financing, healthy balance sheets, and a U.S. economy that's growing at less than four percent annually—remain intact.⁴ Winning and creating value in this environment may require something more: a set of detailed action steps to help companies proactively identify and transact strategic deals rather than reactively pursue disparate, ad hoc opportunities. This article examines some common buyer mistakes during merger waves and suggests ways that companies

can potentially avoid them by becoming advantaged acquirers.

Merger wave challenges

Merger waves happen when deal volumes increase dramatically, crest, and then fall. The first such period began in the 1920s and ended with the Great Depression. Subsequent waves occurred in the 1960s and in each decade since the 1980s. While the reasons behind these merger waves vary, there are several common mistakes that acquiring companies often make during them.

The first mistake is having an **undefined growth strategy** or one that does not clearly consider the role that M&A will play in that growth—both of which can push companies into being reactive buyers. Some companies unwittingly outsource their growth strategy to investment bankers and, as a result, end up reacting to available deals those intermediaries present instead of proactively identifying viable candidates that support their strategic growth goals. While that deal-making process is fairly common in the general M&A landscape, it tends to be magnified during merger waves, as more inexperienced acquirers enter the arena, making capital investments they weren't making before, and experienced players expand their risk profiles in the search for attractive targets.

Overpaying is another mistake that often happens as deal volume escalates. Academics Peter Clark and Roger Mills argue that there are four distinct phases in merger waves, as reflected in assets' purchase prices.⁵ Bid premiums in phase one have averaged just 10-18 percent during merger waves since 1980; premiums rise to 20-35 percent in phase two, reach beyond 50 percent in phase three, and may surpass

100 percent in phase four. This final phase is where many ill-advised and costly deals are struck—often leaving a legacy of broken promises and lost value.⁶

The third challenge is a **lack of options**. Amid continued market volatility, there is concern that the US economy may not be the driver of corporate growth that many had hoped. In such an environment—and often at the urging of activist shareholders—companies may turn to M&A in an effort to increase shareholder value simply because they believe they have no other choice. Also, because deal-making has become so common in certain industries—consumer products, technology, and health care, to name a few—various stakeholders, including investors and company boards, may favor M&A over organic growth.

The potential benefits of being an advantaged acquirer

- Develop a better pipeline of priority targets as part of the company's M&A strategy.
- Save tremendous resources by not focusing on inappropriate deals.
- Be less driven by someone else's (e.g., competitor) timing and rush to close.
- Understand which auctions are most important and which should be avoided.
- Raise diligence and integration issues before valuation and negotiation begin.
- Use landscape education process to reassess growth pathways and alternative transactions.
- Build credibility with the board and efficiently move targets through the pipeline.

Source: Mark L. Sirower, “Becoming a Prepared Acquirer,” *Corporate Dealmaker*, June, 2006

Characteristics of the advantaged acquirer

A large percentage of M&A transactions do not deliver the value promised at the time of the deal.⁷ Acquiring companies that avoid this fate—particularly during merger waves—tend to have a disciplined process that enables them to identify value-creating targets and avoid the likely underperformers, thereby maintaining a competitive edge and delivering shareholder value. The tenets of this process typically include the following:

1. **Self-assessment.** A company's executive team members should assess the organization's strengths, weaknesses, and opportunities for growth, both in revenue and value. This may include deciding which customer segments and associated geographies are most attractive to serve and how to do so in ways that competitors cannot easily replicate; and understanding the capabilities and market access required to achieve those goals. Essentially, a company should develop an M&A strategy to complement strengths and backfill weaknesses. A company that hasn't gone through that process will likely trap itself into being a reactive acquirer, working backward from the deal into a strategy.
2. **Identified priority pathways.** Advantaged acquirers which have conducted a careful assessment know what their M&A priorities are. In other words, they know if M&A is going to comprise 10 percent of their growth, 20 percent, or more. As part of the process, they likely have identified priority pathways at the business-unit (BU) level that address new products or solutions they will bring to market at prices that will add value for customers. Corporate-level growth expectations can be de-averaged to the BU level and used to highlight gaps and prioritize the role of M&A across those units. Without that prioritization, you can likely expect to face a reactive political process—with various business executives championing their favorite deals versus potential deals that are in the best interest of the BU or the company.
3. **Competitor signaling.** It's important to look at competitors' strategic intent. Much can be learned from examining competitors' M&A deals over the last several years in terms of geographies, capabilities, size, product or service offerings, and targeted customer segments. Call it competitor signaling—past behavior will often foreshadow which acquisition targets may be next on their priority lists. Armed with that information, an advantaged acquirer can often determine if a deal it is considering does or does not make sense, or whether to begin preparing for a battle on a priority deal.
4. **Strategic screening.** Once they identify the universe of opportunities, advantaged acquirers strategically screen them. While M&A strategy helps to develop prioritized pathways for growth, target screening filters the deal universe in those pathways to generate portfolios of priority candidates. These filters may include everything from size, geography, and customer segments to technology and talent. Management may debate what the strategic priorities are along those pathways; however, the filters are important strategic choices that can help senior executives and the board to understand why a particular priority target was identified in the first place. As one Fortune 100 executive told us, "The more you look, the more you find; the more you look, the more you learn; and the more you look, the more you test your strategies."
5. **Disciplined execution.** Advantaged acquirers consider integration to be an essential element of target identification and prioritization in the transaction execution process. For example, if the potential for difficult culture issues, such as compensation, autonomy, labor disputes, or distribution gaps exist in a particular deal, acquirers should factor them into the screening process. It can be extremely difficult to analyze synergy potential or conduct a detailed valuation without evaluating such integration risks and determining if the right resources and talent are available to integrate the acquisition effectively.

Reasons to deal: Why will CFOs pursue M&A?

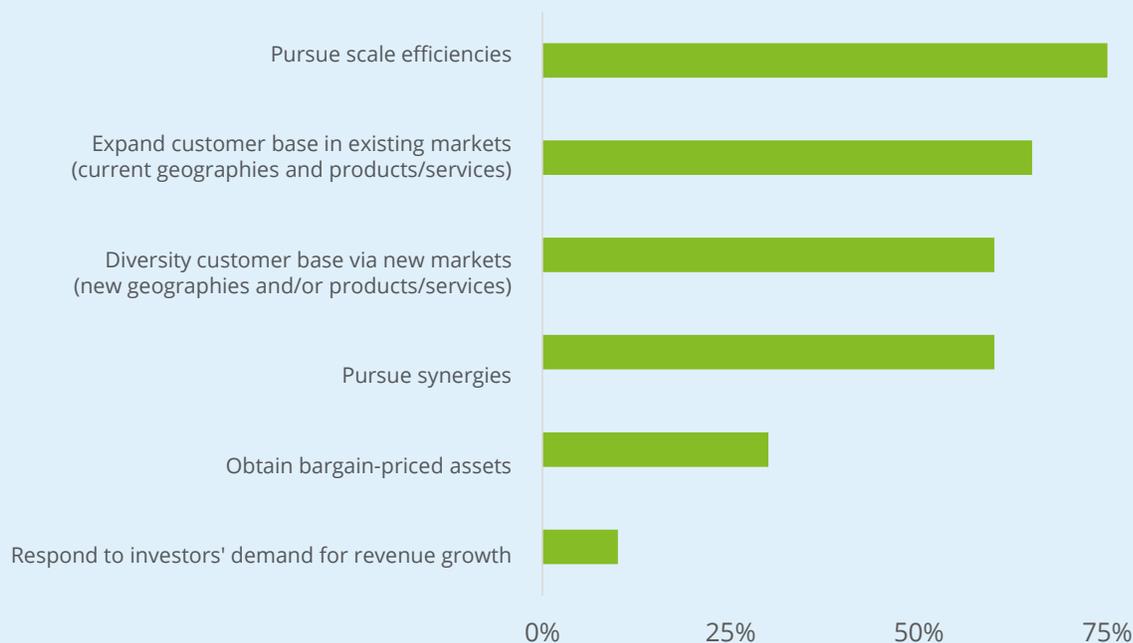
The case for 2016

In Deloitte's Q4 2015 *CFO Signals* report, some 63 percent of CFOs indicated that they expect to pursue M&A deals in 2016. Among them, however, there is considerable diversity of purpose; sometimes reflecting industry differences but often reflecting company-specific factors:

- **M&A deals serve multiple purposes:** CFOs selected an average number of 2.6 purposes for M&A, indicating significant breadth in expected outcomes. Just 17 percent of CFOs selected only one purpose (most often to diversify their customer base or to obtain bargain-priced assets), and 29 percent selected just two purposes (expanding and diversifying their customer base or diversifying their customer base and pursuing scale efficiencies).
- **Heavy growth focus:** About 54 percent of CFOs selected expanding in existing markets, and 51 percent selected diversifying into new markets (27 percent selected both). Overall, 80 percent of respondents selected at least one of these growth purposes. Those who didn't select growth tended to pick a combination of pursuing synergies and scale efficiencies, with a significant number selecting obtaining bargain-priced assets.
- **Heavy scale efficiency focus:** Sixty percent of CFOs selected pursuing scale efficiencies; only one percent solely selected this purpose. Among CFOs not citing scale efficiency, 40 percent chose pursuing synergies, half chose growth in current markets, and 54 percent chose growth in new markets.
- **Vertical integration and consolidation synergies:** About half of CFOs selected pursuing synergies. More than 80 percent of these CFOs also chose a growth purpose, selecting expansion in existing markets (which suggests possible vertical integration strategies) or pursuit of scale efficiencies (which suggests possible consolidation strategies).
- **Bargain-priced assets often an add-on benefit:** Thirty percent of CFOs selected obtaining bargain-priced assets, and almost all of those also chose at least two other purposes—implying bargain-priced assets are often a secondary (or even tertiary) benefit of M&A deals rather than the primary benefit.

What will be the purpose of your M&A deals for 2016?

Percentage of CFOs selecting each purpose (N=70)*



*Results are only for the 63% of CFOs who expect M&A deals in 2016.
Source: *CFO signals*, Q4 2015, January 2016, US CFO Program, Deloitte LLP.

Executive teams bring discipline and patience

To be strategically sound, portfolios In our experience, advantaged acquirers use the above process to develop a watch list of opportunities that they continually refresh. They also tend to close just a small fraction of the potential deals on that list. As long-term successful acquirers, they regularly talk to and negotiate with companies but only pull the trigger on deals that fit their overall strategy at appropriate valuations. In addition, their senior executives typically bring both discipline and patience to the process. Specifically, executive teams act as stewards by determining whether a specific deal fits the company's agreed growth strategy and operating plans. They do so by sticking to their defined rationale and not becoming overly enamored of a particular target so that its acquisition could harm the company. Moreover, executive teams can help bring discipline to the M&A process by assembling the right people in finance and

accounting, technology, operations, strategy, and human resources to make sure that acquired assets are integrated properly. Finally, they can demonstrate patience by having strategic alternatives in case anything goes awry. Along the way, these executive teams are often guided by several common questions:

- Are we looking at the right deals? Being an advantaged acquirer ultimately means knowing the potential targets most important to the company. That involves understanding the universe of opportunities so a company is not in the position where an investment banker or seller proposes a deal the company hasn't already considered.
- Have we measured the transaction's potential impact on ourselves—and our competitors? Acquiring companies should conduct scenario planning to measure how a potential deal could support overall strategy, as well as how it could impede

that strategy if the target was acquired by a competitor. There may be times when it is in a company's best interest for competitors to capture the prize because of the time it will take to integrate the acquisition or the limited value it adds in certain markets.

- Do we have the appropriate integration capabilities? Can we execute this strategy with the resources we have? It's often the financial team's responsibility to not only identify what financial resources should be allocated to the transaction, but also what talent is needed—and the cost of that talent—to integrate the target properly.
- What can we walk away to? A company should always have a best alternative to every deal. As premiums rise, executive teams should be in a position to decide if it is better to buy at 50 times earnings or walk away and do something else with the capital.

Many senior executives complain that they have trouble finding quality assets. One of the other demonstrated benefits of being an advantaged acquirer is that these quality assets typically find the acquirer as it uncovers the universe of opportunities in the market. This holds true for companies of all sizes (see sidebar, “Leveling the playing field”). Once a company has completed its self-assessment, strategy development, target identification and prioritization, the viability of a particular deal should become increasingly clear. And if a deal does not meet agreed-upon parameters, there is often an option to walk away and pursue other high-priority deals on the watch list or to reapply the funds to other segments of the business. After all, advantaged acquirers can afford to be patient—they know what they want.

Leveling the playing field: Tips for mid-sized companies

M&A deals typically fall into the hands of serial acquirers, large companies which have developed this core competency, understand how to strike deals, know how to translate them into shareholder value and, thus, have greater success winning bids. Companies with scale can seemingly afford to take larger risks and pay higher prices. Given this landscape, it can be challenging for mid-size companies to prevail in the M&A auction process, where they often face unique challenges, including: limited M&A experience/skill sets, constrained access to capital, and potential internal resistance from boards unwilling to approve high valuations or take on perceived risk. In short, mid-sized organizations typically appear outgunned—however, they may significantly improve their odds of winning by following the first principle of an advantage acquirer—self-assessment—and doing the following:

- **Prepare to make smarter and bigger bets**—Being crystal clear about which targets are absolute “must-haves” may enable a mid-size buyer to engage in an exclusive deal, avoiding the auction process altogether. If the target does call for an auction, defining the unique value proposition for these assets and the strategic trade-offs may bolster company confidence to pay higher premiums.

- **Build a reputation as an “acquirer of choice”**—Sellers prefer being acquired by companies that will accelerate their value-creation trajectory, a consideration that is often as important as price (especially if the target’s management remains in place or has a continuing financial interest in the company). Building a reputation as an acquirer of choice takes time, but can start with communicating the company’s value proposition, strategic intent, and corporate culture principles.
- **Be a serious and engaged buyer**—Sellers gravitate to buyers that create certainty. Mid-size companies should be prepared to explain a well-designed deal rationale and integration strategy to the target’s management. Buyers should actively participate during due diligence, asking the right questions, and proactively addressing the seller’s integration concerns. Prudent use of experienced external advisors can augment internal M&A capabilities, aid preparation and professionalism, and raise the buyer’s level of credibility and certainty.

While mid-sized companies will often feel like M&A underdogs, they can tip the odds in their favor and, in doing so, be positioned to win a greater share of the acquisitions they pursue.

End Notes

1. "2015 Was Best-Ever Year for M&A; This Year Looks Good Too," Bloomberg, January 6, 2016, <http://www.bloomberg.com/news/articles/2016-01-05/2015-was-best-ever-year-for-m-a-this-year-looks-pretty-good-too>.
2. CFO Signals, Q4 2015; <http://www2.deloitte.com/us/en/pages/finance/articles/cfo-signals-survey-executives-sentiment-betting-america-despite-concerns-2015q4.html>.
3. "Riding the wave," *The Economist*, <http://www.economist.com/news/business/21587207-corporate-dealmakers-should-heed-lessons-past-merger-waves-riding-wave>, October 2013.
4. "National Income and Product Accounts: Gross Domestic Product: Fourth Quarter and Annual 2015 (Second Estimate)," Bureau of Economic Analysis, <http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm>, February 2016.
5. "Masterminding the deal: Breakthroughs in M&A strategy and analysis," Peter Clark and Roger Mills, Kogan Page, August 2013.
6. Masterminding the deal: Breakthroughs in M&A strategy and analysis, Peter Clark and Roger Mills, Kogan Page, August 2013: (Original source of acquisition purchase premium (APP) percentages, *Beyond the Deal: Optimizing Merger and Acquisition Value*, see pp 20-23, 47-54; Harper Business, 1991.)
7. "Integration report 2015: Putting the pieces together," Deloitte LLP, <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/mergers-acquisitions/us-ma-integration-report-030415.PDF>

Contacts

Mark Sirower

Principal
Deloitte Consulting LLP
msirower@deloitte.com

William Engelbrecht

Principal
Deloitte Consulting LLP
wengelbrecht@deloitte.com

Steve Joiner

Partner
Deloitte & Touche LLP
sjoiner@deloitte.com

M&A Institute

About the Deloitte M&A Institute

The Deloitte M&A Institute is a community of clients and practitioners focused on increasing the value derived from M&A activities, powered by Deloitte's M&A Services capabilities. The Institute serves as a platform to build connections, showcase thought leadership, and accelerate experience and learning for those involved.

Deloitte.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about for a detailed description of DTTL and its member firms. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.