Valitas Insights: Experience Breeds Success: An M&A Strategy that Creates Value

Recent acquisition activity, as set out in Pitchbook's Global Q3 2016 M&A Report, gives us cause for pessimism. As we have noted previously, factors relating to negative outcomes are pervasive in current transactions. **This week, however, our focus is on the positive as we consider an M&A strategy that is proven to create value.**

The McKinsey article, "Taking a Longer-Term Look at M&A Value Creation", summarizes a study of M&A activity of the world's 1000 top non-banking companies over a ten-year period. The authors classify companies' M&A strategies into 5 different categories:

1. *Programmatic:* Companies that make ongoing acquisitions which, in aggregate, comprise a material level of investment for the company;
2. *Selective:* Companies that do an occasional deal, but don't appear to have a defined M&A strategy;
3. *Tactical:* Companies that do numerous small deals, the combined value of which does not represent a significant portion of their market capitalization;
4. *Large:* Companies that make single acquisitions exceeding 30% of their market capitalization; and
5. *Organic:* Companies that have no acquisition strategy but rely solely on organic growth.

So which strategy creates the greatest shareholder value?

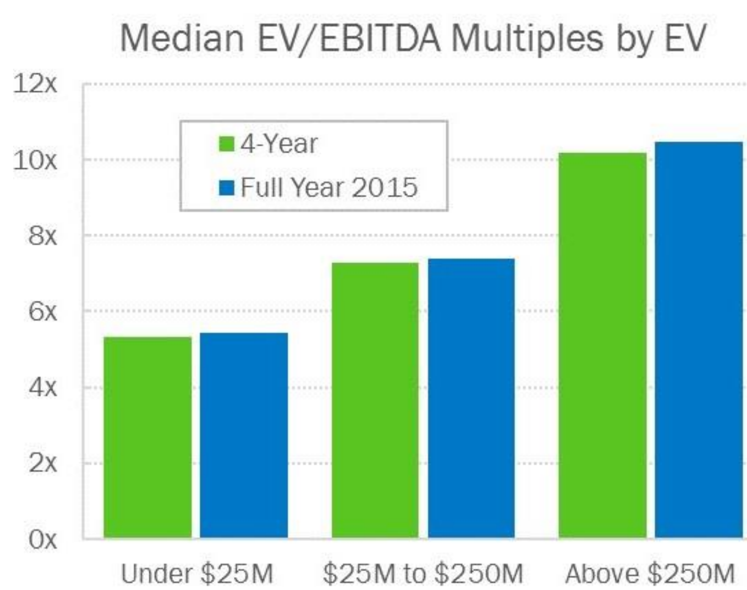
The results of McKinsey's study are clear. Across industries, companies generate the most value using the programmatic strategy – that is, engaging, on an ongoing basis, in a series of smaller transactions that, in aggregate, are materially significant.

Specifically, these "programmatic" value creation champions:

i. perform better than companies relying solely on organic growth;
ii. generate higher "excess shareholder returns" than companies relying on other M&A strategies; and
iii. are exposed to less risk (variability in returns) than companies that do not engage in M&A activity.

In addition, the authors note a volume effect. Within the programmatic strategy segment, companies that do more deals have an increased probability of generating excess returns. Organizational competence in M&A is clearly at work here, as management develops and continually refines the infrastructure and capabilities required to identify targets, engage them in strategic dialogue and then manage the transaction and integration processes.

Further support for a programmatic acquisition strategy is found in historical transaction multiples set out in Pitchbook's PE Multiples and Trends Report. It is noteworthy that deal multiples are significantly lower for smaller acquisitions than for large acquisitions. This could account, at least in part, for the greater value realized through a programmatic acquisition strategy.



The McKinsey study's findings, supported by 10 years of data, suggest that a programmatic acquisition strategy yields greater shareholder value than other M&A strategies or strategies relying entirely on organic growth. Lower deal multiples for smaller transactions further support a programmatic approach to M&A. Establishing the capability to develop and implement this type of acquisition plan is certainly a worthwhile undertaking for those companies that aspire to consolidate their industries.