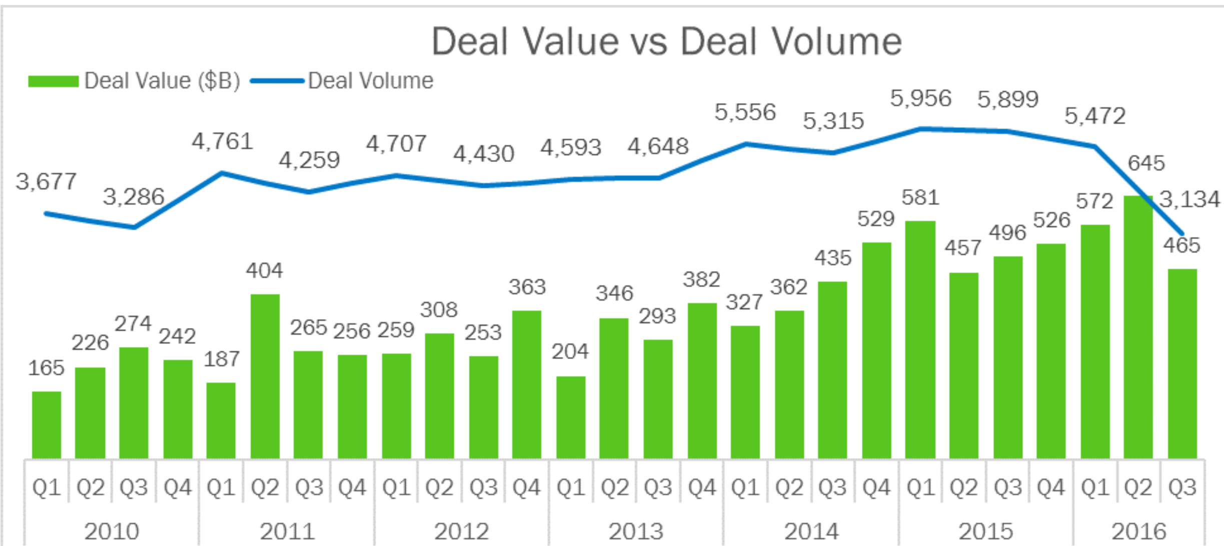
Valitas Insights: Large deals, high valuations…Are current M&A transactions creating value?

"Larger corporate acquisitions buttress deal value". This is the headline in PitchBook's recently released [Global Q3 2016 M&A Report](). While the report notes that deal count dropped off considerably in the third quarter, average deal value continued to increase (up 42% over Q1) as acquirers, armed with excess cash and highly valued stock currency, bid up valuations on a decreasing pool of quality targets.



So does this acquisition activity translate into value? A study by S&P Global, reported in a recent Association for Corporate Growth webinar, provides some answers for acquirers and investors. Study authors compared M&A transaction attributes to shareholder returns, and acquirers against their industry peers. Our takeaway: we have good reason to be pessimistic, as the authors identified factors relating to poor acquisition outcomes similar to what we are witnessing in the current environment.

These include:

1) large acquisition size relative to acquirer market capitalization (larger targets related to worse outcomes)

2) % of stock consideration paid (higher percentage stock consideration related to worse outcomes)

3) excess cash on balance sheet

In addition, acquirers expecting "synergies" to justify high valuations were typically disappointed, as those synergistic cost savings often proved elusive.

These findings do not bode well for the current M&A environment. Assuming a more positive lens, however, the authors identified that successful acquirers were most often serial acquirers that gained deal and integration experience doing frequent transactions rather than one-off, large acquisitions. This is consistent with McKinsey's findings in its article, "Taking a Longer-Term Look at M&A Value Creation".

The McKinsey article concluded that companies engaging in a "programmatic approach" to M&A generated excess returns relative to their peers, including those focused on organic growth. In contrast, those companies engaging in a large deal (and by necessity, less frequent) approach to M&A generated negative excess returns.

The programmatic strategy consists of making ongoing acquisitions that, in aggregate, comprise a material level of investment for the company. **While this type of high-volume growth strategy requires management capability, evidence supports the value of creating an infrastructure to manage a focused "programmatic" or serial acquisition approach to M&A.**