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Corporate Finance

Making M&A deal synergies count

When investors understand where deal value comes from, they tend to reward companies up front.

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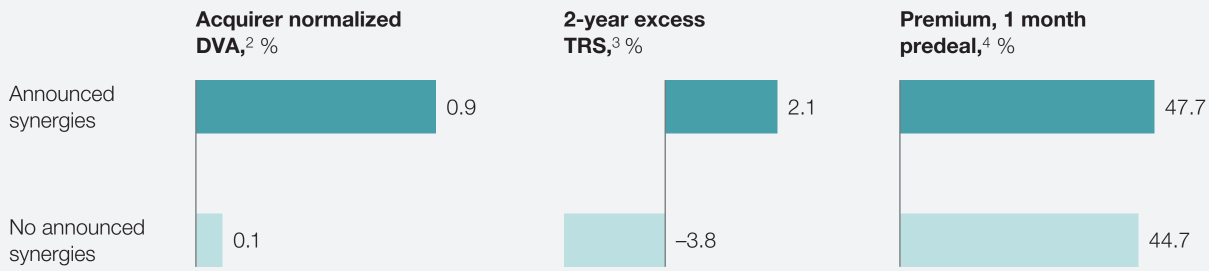
Information is the lifeblood of investor efforts to confirm—or challenge—their confidence in a company's ability to create value. This is especially true when companies make deals large enough to redirect, reshape, or even completely redefine a company's strategy. It's only natural for investors to want to know what to expect—to give them confidence that the deal price isn't just value being transferred to a target company's shareholders. And when companies aren't forthcoming, investors may well interpret it as a sign that managers don't know how they'll make a deal work.

That's why holding back may reflect a missed opportunity for many acquirers. In our analysis of 1,640 deals over the past seven years, we found that on average, companies making acquisitions have been paying a premium of 40 percent or more than their targets' market value. And while they typically justify those premiums with a nod to potential synergies from the deal, few actually specified those synergies in their deal announcements. Since 2010, only about 20 percent of acquirers publicly disclosed the synergies they intended to capture.

Companies may have their reasons for keeping mum. Sometimes managers feel compelled to move too quickly to compile the data. Sometimes they fear overpromising, especially when the underpinning data, talent, or pipeline are incomplete. Sometimes the data they have doesn't support a simple synergy story. And sometimes they execute deals for strategic reasons besides synergies, such as to acquire R&D capabilities, intellectual property, or emerging technology.

Exhibit 1 **Acquirers who announce synergies enjoy stronger returns than those who don't—in spite of higher premiums.**

Large public transactions, 2010–17, year-to-date[1]

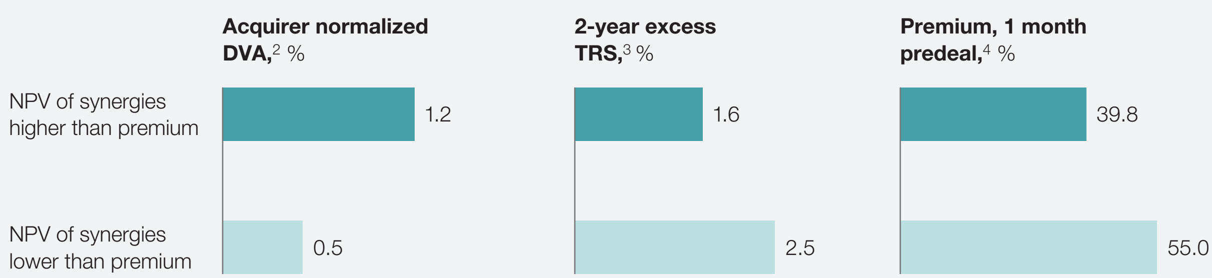


[1] Includes largest acquisitions across multiple nonfinancial sectors; only includes deals where the target is a publicly traded company.
[2] DVA = deal value added. Average acquirer total return to shareholders (TRS) in excess of industry-sector TRS, around time of the deal (2 days preannouncement vs 2 days postannouncement).
[3] Average acquirer long-term TRS in excess of industry-sector TRS, 1 month predeal vs 2 years postdeal.
[4] Average premium announced based on target share price 30 days before deal announcement.

Source: Capital IQ; Dealogic; MSCI; McKinsey's SynergyLab

Exhibit 2 **Among acquirers that announce synergies, the initial market reaction is stronger when the net present value (NPV) of synergies is higher than the premium paid.**

Large public transactions where synergies were announced, 2010–17 year-to-date[1]



[1] Includes largest acquisitions across multiple nonfinancial sectors; only includes deals where the target is a publicly traded company.
[2] DVA = deal value added. Average acquirer total return to shareholders (TRS) in excess of industry-sector TRS, around time of the deal (2 days preannouncement vs 2 days postannouncement).
[3] Average acquirer long-term TRS in excess of industry-sector TRS, 1 month predeal vs 2 years postdeal.
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Source: Capital IQ; Dealogic; MSCI; McKinsey's SynergyLab

But where companies have a synergy story to tell, they should be as forthcoming as they can be. Our analysis finds the following:

- Investors reward acquirers with a higher share price when they disclose the sources of value in their deal announcement (Exhibit 1). This assumes that the deals where acquirers announced synergies were good ones with clear expected synergies. Acquirers that made such announcements earned a higher deal value added[1] in the days around the deal's announcement, even though, on average, they paid slightly higher premiums than the companies that didn't specify synergies. And then, as the deals matured, they enjoyed around a six-percentage-point boost in two-year excess TRS compared with those that didn't mention synergies.

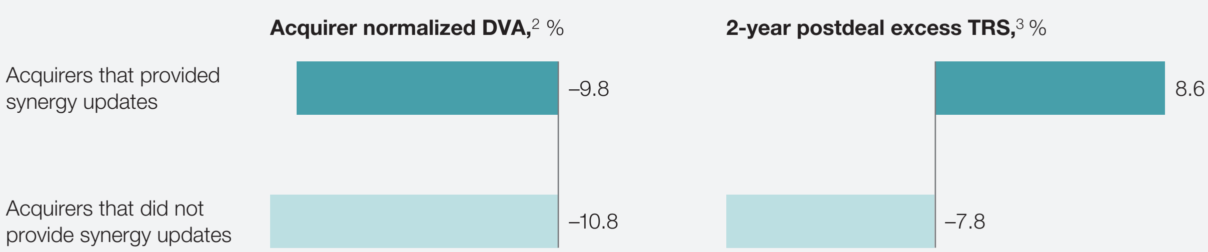
- Not surprisingly, our analysis confirms that when the expected long-term value of the cost synergies is greater than the premium paid by the acquirer, investors are even more enthusiastic about the deal (Exhibit 2). That return-on-investment perspective isn't always visible or convincing unless companies explicitly describe expected synergies when they announce a deal—as suggested by the higher longer-term TRS of companies with expected value that doesn't cover the premium.

- Finally, we found that acquirers that updated the market on synergy benefits during deal integration were more likely to maintain the positive share-price effect of synergy announcements. Our analysis found that even those whose deals initially received a muted market reaction often see significantly higher excess TRS two years after the transaction when they provided synergy updates (Exhibit 3). Two-year excess returns are important, since that time frame reflects successes in cultural integration and maintaining a deal's business momentum—which lead to synergies. Initial

Exhibit 3

Deals with initially lackluster market reactions outperformed in the long term after investors were updated on synergies.

Large public transactions, 2010–17 year-to-date,[1] acquirers with negative DVA[2]



[1] Includes largest acquisitions across multiple nonfinancial sectors; only includes deals where the target is a publicly traded company.
[2] DVA = deal value added. Average acquirer total return to shareholders (TRS) in excess of industry-sector TRS, around time of the deal (2 preannouncement vs 2 days postannouncement).
[3] Average acquirer long-term TRS in excess of industry-sector TRS, 1 month predeal vs 2 years postdeal.

Source: Capital IQ; Dealogic; MSCI; McKinsey's SynergyLab announcement effects are not correlated with value creation.[2]

Of course, investors don't reward companies just for making announcements. They reward companies for the present value of future earnings from a deal. When companies announce synergies, they give investors a deeper understanding of the deal rationale. When they update investors on progress during integration, they build trust and confidence in their skills as stewards of investor resources.

In our experience, more information is better. Acquirers should disaggregate the cost, capital, and revenue synergies, and provide a clear rationale and vision for each. They should communicate a timeline for when they expect the synergies to be fully recognized and what one-time investments and costs are required to capture the synergies. And their communiqués to investors should clearly identify any risks that could prevent the companies from capturing the synergies, along with mitigation plans. ■

[1] For M&A involving publicly traded companies, this is defined as combined (acquirer and target) change in market capitalization, adjusted for market movements, from two days prior to two days after announcement, as a percent of transaction value.

[2] Werner Rehm, Robert Uhlaner, and Andy West, "Taking a longer-term look at M&A value creation," January 2012, McKinsey.com.

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