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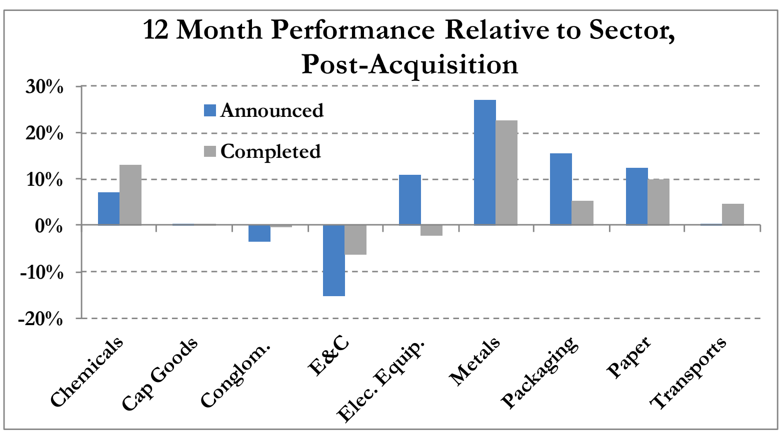
M&A – Shareholder Value Can Be Created – But The Bad Deals Get All The Attention

Executive Summary

While we saw a number of interesting M&A transactions in 2012, the pace has heated up in 2013, and if you believe the hype, we should expect to see many more. Generally, there is plenty of cash, there is precious little organic growth, borrowing is cheap and there is no-end of persuasive advice (all of course attached to very high fees). The Industrials and Basics group is no exception to this. However, outside Metals and Mining (and this claim is looking shaky today), companies in these sectors rarely generate a level of shareholder value from acquisitions that merits the premiums paid.

Analyzing 187 deals across the sectors over the last 25 years, 12 month forward returns (relative to the sector) from the acquirer, post announcement, are positive – averaging 6%, with a median of 1.2%. More share price risk for acquirers occurs post close than post announcement, with average returns relative to sector 200 basis points lower than post announcement. The sectors where you are most likely to get negative returns post both announcement and completion are Capital Goods, Conglomerates and E&C – with E&C showing a terrible record. Acquisitions that were made in the period from 2000 – 2010 provided more relative upside for acquirers than prior to 2000 or recently. Metals and Mining is an overall positive outlier because most deals took place between 2000 and 2008.



While the averages are interesting, there are good deals and bad deals in each sector. Again the difference appears to come down to the optimists versus the more conservative group. The optimists have far more asset write downs than the pessimists suggesting that they overestimate what they are getting and what they can do with it and they overpay. The analysis is a little counter-intuitive as we would have expected a worse set of results. This is partly because it is human nature to remember the bad deals more clearly than the good ones. There is also no size correlation – big deals are not more likely to be better or worse than small deals.

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M&A is another subject in the broader and critical question of capital allocation. We have written on capital spending and dividend policy and we will shortly publish on R&D. Collectively these constitute the main capital allocation decisions that any corporate leadership must take. Companies win and lose on capital allocation decisions, and much of the work that we offer on a bespoke basis focuses of appropriate use of capital. It is a subject that has been central to investment research written at our SSR subsidiary and written at our tenures with other research organizations. Get it right and you have a great company and a great stock; get it wrong and you always underperform. To get it right, however, you first have to know what you really do and what real opportunities are available to you, and this ties back neatly to our recent piece on optimism.

Please contact us to view the full report.

Pentant Disclaimer and Sources

Sources:
All of the data shown in the charts in this report and mentioned through the text were obtained from publicly available sources and corporate reports, much of it aggregated through Capital IQ. We also use Bloomberg, IHS and government data bases.

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