Updating your synergy playbook

Four tactics to deliver better deal results

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Deal success is challenging.

Historically, almost 70 percent of acquisitions have failed when measured by the acquirer's shareholder returns relative to the market. Why? Executives consistently cite synergies as one root cause for deal failure. Whether synergies were overestimated, cost too much to achieve, were not captured, or were delayed, the result is the same—poor returns on the deal investment and depressed value to the buyer's shareholders.

A fresh take on synergies can improve results

Executives should evolve their approach to synergies to improve deal results. Based on our experience with acquisitive corporations, a recent survey of corporate development executives, and interviews with senior corporate development officers, we have identified four key tactics to improve synergies and deal results:

- Don't dismiss revenue synergies.
- Use "clean teams" to uncover and achieve synergies earlier and to gain more confidence on deal theses with improved data access.
- More closely link synergy analyses to valuation and negotiation.
- Use the deal opportunity to "do more" and pursue other key strategic goals during integration.

Do not dismiss revenue synergies

Relative to cost synergies, revenue synergies often get short shrift from deal teams. Cost cutting is more tangible and more easily assessed, and cost synergies are frequently, by themselves, sufficient to justify an acquisition. On the other hand, revenue synergies are seen as elusive and often fully discounted by acquirers during valuation.

Historically, deal makers may have been too quick to dismiss the true value of revenue synergies. In recent KPMG interviews with corporate development executives, one former EVP for M&A of a Fortune 500 company said, "I hate revenue synergies. I don't believe in them." Another corporate development executive said, "We apply a low probability to revenue synergies. We view them as just gravy." These more traditional views of revenue synergies do not take into account their potential value to dealmakers.

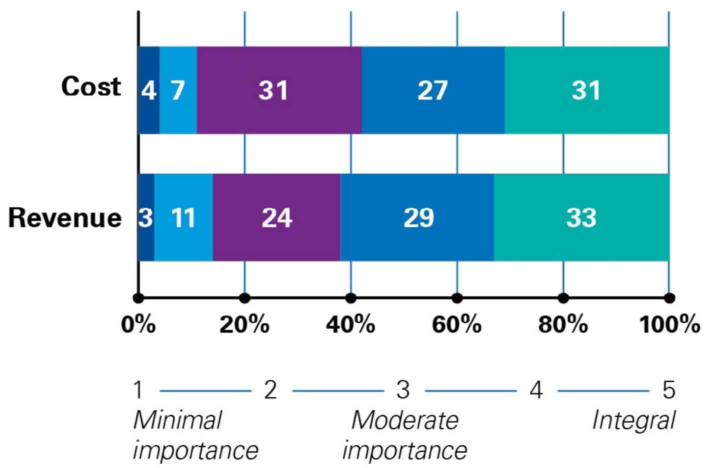
Even though historically executives tend to discount revenue synergies, a recent KPMG survey hints that executives are beginning to embrace an approach that places more value on revenue synergies (see Exhibit 1).

When asked how important revenue synergies were to their deal theses, the largest percentage of respondents (33 percent) said that revenue synergies were integral to their companies' deal theses. Only 3 percent said that revenue synergies had minimal importance. Interestingly, our survey respondents rated revenue synergies about as important as cost synergies. In terms of cost synergies, 31 percent of respondents said they were integral to their deal theses and 4 percent said that cost synergies had minimal importance.

Corporate development executives view cost and revenue synergies as comparably integral to deal theses

Exhibit 1

Percentage of respondents rating importance of revenue and cost synergies to deal theses



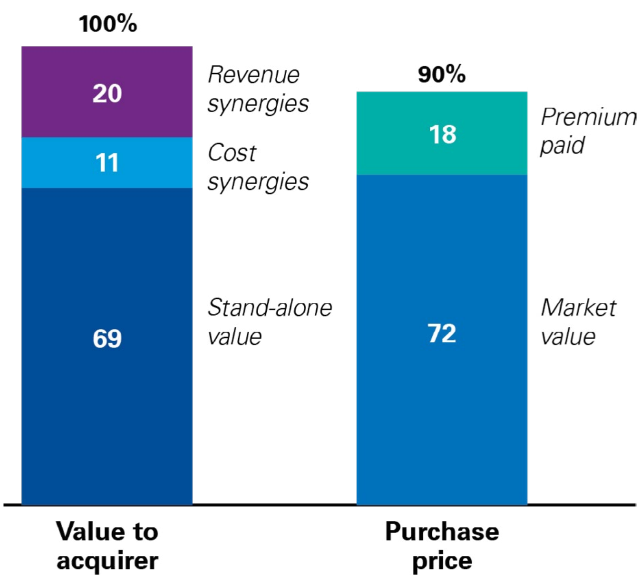
Source: KPMG Research

What is causing this shift? Revenue synergies have always represented real potential value to acquirers. But in a frothy market, the value ascribed to revenue synergies can determine whether a buyer pursues an acquisition—and who wins in sales processes. For example, in one recent retail acquisition that KPMG worked on, both revenue and cost synergies were crucial factors in determining the potential deal value and ultimate purchase price (see Exhibit 2). In that case, cost synergies (e.g., largely driven by centralizing administrative functions and leveraging increased purchasing scale) amounted to about 11 percent of the potential value to the acquirer; revenue synergies (in this example, leveraging the acquirers overseas distributor relationships and cross-selling products) amounted to 20 percent of the potential value to the acquirer. That analysis allowed the acquirer to offer an 18 percent premium to the target's stock price, win the bid, and still assume an increased potential value of 10 percent.

Revenue synergies are, in frothy markets, often needed to generate value for buyers and can determine who wins an auction

Exhibit 2

In a recent consumer goods transaction, revenue synergies were key to deal viability



Clean teams can improve the accuracy of synergy projections

Developing accurate synergy estimates—particularly revenue synergies—is challenging. Too often, pre-deal estimates of synergies are based on back-of-the-envelope analyses and assumptions made with limited access to key data points. Clean teams can help acquirers improve their analyses.

What exactly is a clean team? A clean team is a third-party, independent entity that is given access to the target's and acquirer's sensitive company data. With guidance from the acquirer's management team, the clean team is able to collect and analyze information that will help an acquirer improve its synergy projections as well as other important deal assumptions. Traditionally, a target will give a clean team access to numerous types of confidential information, such as customer data and supplier data, as well as pending strategic initiatives and R&D investments.

In addition to getting access to the most important information, using a clean team also provides acquirers an advantage when it comes to analyzing the data. The clean team will help to ensure that the buyer's business case is adequately vetted and that the critical assumptions are supported by the data provided. This step is an important pre-deal step, but also has substantial post-deal advantages. The acquirer will now have valuable information and analyses that can provide a head start once integration begins.

We have seen an increasing percentage of companies use clean teams during due diligence, which has improved the diligence results. In a recent client example involving a telecommunications company, using a clean team was the only way to identify and quantify half of the ultimate synergies; accurately predicting the deal's synergies (both cost and revenue) were, in turn, key to confirming the acquirer's deal thesis and winning the auction.

Synergies should be aligned with valuation and bid strategy

Getting synergies right, while challenging, is only a first step.

Our research and client experience indicates that the best acquirers then carefully inform their bid strategy based not just on their own synergy estimates, but also informed by an assessment of the synergies that other likely bidders would generate from the deal.

In a recent successful deal, KPMG supported a client in assessing the synergy potential not just from the combination of the client and the target, but also from the combination of the target with three other likely bidders (see Exhibit 3). Based on this analysis, the client was able to develop a negotiating strategy that maximized both the likelihood of winning the auction and the value creation potential.

Leading acquirers link synergy analysis—their own and that of likely bidders—to bid strategy

Exhibit 3

In a recent media transaction, an analysis of likely bidders' synergy informed the ultimate buyers initial and final bids

		Likely bidders		
Value (indexed)	**Client**	**A**	**B**	**C**
Stand-alone	**56**	**56**	**56**	**56**
Cost synergy	**41**	**13**	**34**	**12**
Revenue synergy	**3**	**6**	**5**	**11**
Total	**100**	**75**	**95**	**79**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Use the deal as the opportunity to "Do More"

Sizable acquisitions are major change events and there is bound to be corporate disruption. While integrating an acquisition is a major undertaking, many companies have found it to also be a surprisingly good time to tackle other change initiatives.

Ideally, a merger will support a company's long-term strategic growth objectives. However, there are likely other less transformational, but still performance enhancing, steps that a company could pursue in support of those or other objectives. Companies should consider how to improve synergies other than those identified during due diligence and determine if the company requires a major IT upgrade or other infrastructure improvements. Using the integration phase to tackle other business objectives can improve deal and other business metrics.

For example, KPMG recently worked with a grocery retailer that leveraged the momentum of an impending acquisition to push through an organizational delayering effort and to kick off several other initiatives. Those initiatives, which were not deal related, had been planned out, but on hold for some time, and were pushed forward based on momentum for change unleashed by the deal.

These additional initiatives obviously complicate what is already a very challenging process. In order to tackle both an integration and other programs, companies need to leverage the diligence period to compile a wide range of baseline data to inform the items on the "do more" list. The ultimate diligence phase should be used not just to gather a wide range of information, but also to conduct a deep analysis using data & analytics tools to identify and address performance improvement opportunities, whether related to the deal or not.

Conclusion

Getting synergies right can greatly enhance deal results. KPMG research and experience has identified several approaches that should help deal makers improve synergy projections and related processes, as well as help them prioritize and capture synergies post-close. Companies should not give up on revenue synergies, should pursue diligence using a clean team, align their valuation and bidding process with synergy assumptions, and use the M&A process to pursue other important business goals.

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How KPMG can help

As a leading deal adviser on several hundred global M&A transactions each year, leveraging proprietary data and analytical tools in working with some of the largest global corporations and private equity funds, KPMG is well-placed to guide you through your acquisition journey, from strategy development to deal sourcing through to deal execution and integration.

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