

# FROM BUYING GROWTH TO BUILDING VALUE

INCREASING RETURNS WITH M&A



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# EXECUTIVE SUMMARY

*THE INDICATIONS OF RECOVERY* early in 2014 proved prescient. The full year saw the global number of M&A deals and total deal value return almost to 2005 and 2006 levels, which were surpassed only by the heights achieved prior to the dot-com collapse in 2000 and the financial crisis in 2008. M&A activity has been broad based geographically—with double-digit increases in all the major regions of the world—and has taken place across a wide range of industries. The deals in each industry, however, are rooted in that sector’s or segment’s particular dynamics. The long-awaited recovery appears to have legs—deal volume and deal value have continued to show strength in the first two quarters of 2015—although it bears remembering that M&A cycles are getting shorter over time, and the drop in deal value from the past two market peaks was severe—more than 80 percent within 18 months of the high points in 2000 and 2007.

*In last year’s M&A report, we discussed how the market was being fueled in part by a continuing rise in divestitures, which represent a powerful strategy for unlocking value and improving performance by focusing on core operations. (See “Creating Shareholder Value with Divestitures,” BCG article, September 2014.) Divestitures continue to be a vital source of M&A activity. But as economies around the world improve, corporate cash reserves grow, and financing remains cheap, the question in the boardroom becomes, “How do we spend the money?”*

*For CEOs in high-growth sectors, such as technology, there are plenty of opportunities to invest in organic expansion through new products, markets, and locations. For companies in more mature industries—energy, health care, consumer goods, and financial services, to name a few—the outlook for internal growth is often less robust. One answer to the spending question lies in channeling cash reserves and inexpensive financing into growth through acquisition. But even as M&A volumes soar, big questions linger around the ability of companies to generate value by buying their way to growth.*

*Acquiring revenue is certainly one way to grow the top line, but economists, M&A professionals, and other experts frequently debate how successful ac-*

*quisitions are at delivering bottom-line growth—and especially growth in value for shareholders. Our own research, based on BCG’s proprietary global database of more than 40,000 M&A transactions since 1990, shows that the results vary widely and depend on a range of factors, including industry, market dynamics, metrics measured, time frame, and an individual company’s own history and experience with making and integrating acquisitions. This year’s M&A report examines the impact of all of these factors and draws some critical lessons for companies considering M&A as a source of growth.*

### **After all the hopeful signs evidenced in 2013, 2014 delivered.**

- Total transaction value jumped more than 20 percent to almost \$2 trillion, the recovery took in a wide range of industries and players, and the rising number of deals in each successive quarter established a fast-paced momentum that has carried into 2015.
- While the increase in deal making was broad based across sectors and industries, three global trends propelled much of the activity: hot high-tech markets, companies seeking to adapt to a “new normal” in their sector or industry, and consolidation along with the hunt for innovation.
- The year 2014 might be remembered as much for the deals that didn’t happen as for those that did. Unsuccessful or terminated takeover attempts reached their highest level since 1999. Almost a quarter of announced deal value failed to reach consummation. Investors might well have missed opportunities to profit on both ends of these transactions as 2014 was one of those rare years in which M&A resulted in net gains for shareholders of both acquirers and targets.

### **Will deal volume and value continue to rise?**

- With median enterprise-value-to-EBITDA multiples at 12.3 in 2014, acquirers are buying at lofty price levels. At the same time, average takeover premiums of 27.7 percent in 2014 are still about 4 percentage points below their longtime average of 32 percent.
- Interest rates remain low, credit is readily available, and buyers are willing to borrow.
- Both corporate and private-equity players have substantial and growing resources that they need to put to work.
- M&A is one of a few remaining strategic alternatives, especially for companies seeking growth.

### **Acquisitive companies grow faster.**

- Companies that make acquisitions have higher short-term revenue growth rates than those that do not—8.3 percentage points higher in a typical five-year period.

- Not surprisingly, the more acquisitions a company makes, the higher its rate of revenue growth—17 percent a year for those making one to two acquisitions over a five-year time frame, and 23 percent for those doing more than five deals.
- Acquisitive companies also grow faster over the long term—that is, 25 years or more—by a rate of a full percentage point each year, which translated into additional annual revenue of \$900 million after 25 years for the average company in our sample.

**But covering integration costs and realizing the synergies that generate growth for the bottom line are complex undertakings.**

- Nonacquisitive companies increased EBITDA at the same rate as they increased sales—an average of 9 percent.
- Acquirers increased EBITDA faster—an average of 15 percent—and the more companies they acquired, the faster the earnings increased.
- Growth in EBITDA for acquirers was, on average, slower than the growth in sales by 1 to 3 percentage points.
- The more experienced the acquirer, the better its chances of overcoming the margin challenge.

**Does acquiring growth generate value for shareholders?**

- Companies can grow—and grow profitably—through acquisition, but how do they ensure that value follows?
- Acquiring companies are selective. The average acquirer reviews roughly 20 candidates before closing a deal. But research also shows that extensive selection does not by itself guarantee success—or vice versa.
- The big issue is that most companies are not frequent acquirers and postmerger integration (PMI) is not a core skill. Initial high hopes are often followed by lower-than-expected synergies and lengthy integration processes.
- While inexperienced acquirers typically destroy value for their shareholders, frequent acquirers outperform their nonacquisitive counterparts. This holds true across 5-year, 10-year, and 25-year horizons.
- In order to realize the most value from acquisitions, M&A and PMI should be approached in a systematic and rigorous manner, just like any other management process.

# THE M&A RECOVERY PICKS UP PACE

**A**FTER ALL THE HOPEFUL signs evidenced in 2013, last year delivered: 2014 was a banner year for M&A. Total transaction value jumped more than 20 percent to almost \$2 trillion, the recovery took in a wide range of industries and players, and the rising number of deals in each successive quarter established a fast-paced momentum that has continued in 2015. (See Exhibit 1.) Total deal value in just the first half of this year reached 65 percent of total deal value in all of 2014, and there have been multiple huge and high-impact deals announced in such industries as energy, media, health care, consumer products, and financial services.

M&A activity has been broad based geographically, with all the major regions of the world showing double-digit increases in 2014 over 2013. Megadeals (deals with values of more than \$10 billion), which we highlighted in last year's report as a reemerging trend, played a big role in the 2014 results. There were 14 such deals completed in 2014, with an aggregate value of \$262.3 billion or 14 percent of the total deal value for the year.

North America was the most active M&A market, racking up nearly \$1 trillion in total deal value—an 18 percent increase over 2013. Low interest rates, which helped propel rising valuations, as well as ample corporate and private-equity cash reserves, all fueled deal volume. Private-equity players were both big

buyers and big sellers as markets were receptive to both trade sales and IPOs. Psychology also played a role as some companies feared losing opportunities if they did not move—a dangerous development, in our judgment, as similar dynamics helped inflate the 2000 and 2007 M&A bubbles prior to their bursting. Other companies continued to prune nonstrategic operations in order to capture rising asset values.

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There were 14 megadeals in 2014, with an aggregate value of \$262.3 billion.

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Asia-Pacific recorded the biggest increase in deal value in 2014 over 2013—a 50 percent jump to almost \$330 billion. Megadeals contributed substantially; five megadeals accounted for more than a quarter of the overall value of all Asia-Pacific deals. China was especially active, accounting for 46 percent of total deal value and 30 percent of total deal volume in the Asia-Pacific region in 2014.

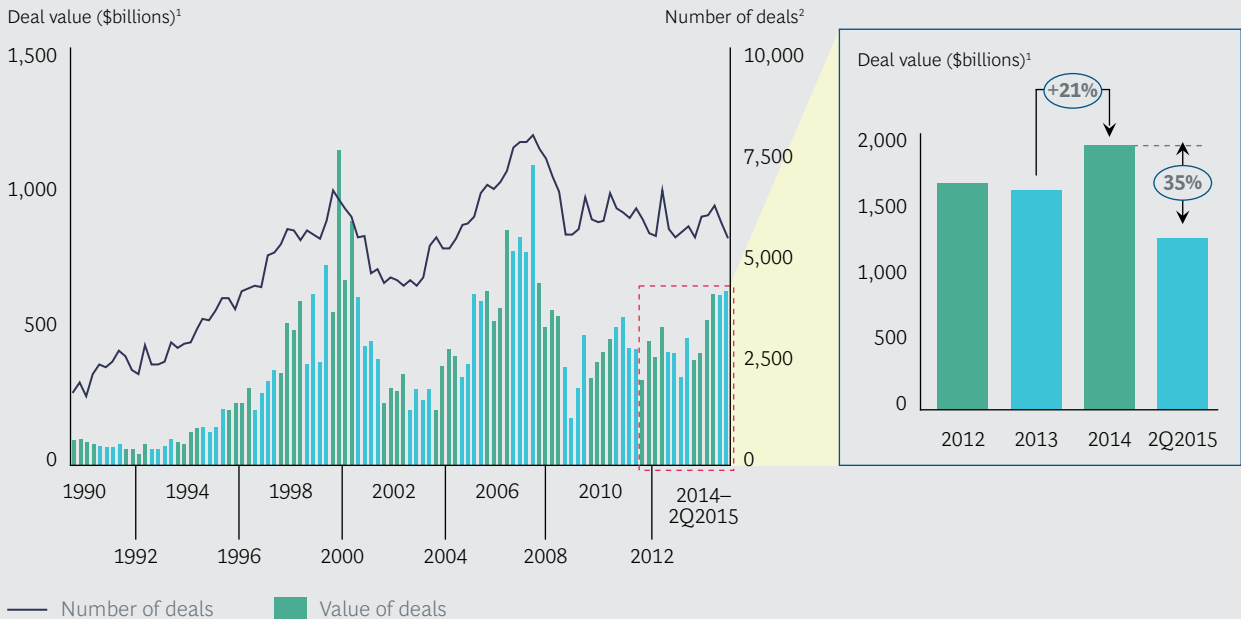
Europe and the rest of the world also showed strong growth as improving economies provided corporate and private-equity buyers with the confidence to pursue large transactions on a level not seen in recent years. As



## EXHIBIT 1 | Global M&A Activity Remains Strong in 2015

M&A ACTIVITY STABILIZED TO THE LEVELS OF 2005 AND 2006

65 PERCENT OF 2014 DEAL VALUE ACHIEVED IN THE FIRST HALF OF 2015



Sources: Thomson ONE Banker; BCG analysis.

<sup>1</sup>Enterprise values include the net debt of targets.

<sup>2</sup>The total number of deals comprises 498,479 M&A transactions, with no transaction-size threshold, and excludes repurchases, exchange offers, recapitalizations, and spin-offs.

elsewhere, the number of megadeals and deal values soared. Strategic priorities included geographic expansion (especially for buyers from outside Europe eyeing prime European assets), the search for scale and growth, and industry consolidation. Activity might have been even higher but geopolitical tensions surrounding Ukraine cooled activity in Eastern Europe.

### Three Global Trends

While the increase in deal making was broad based across sectors and industries, three global trends propelled much of the activity: hot high-tech markets, companies seeking to adapt to a “new normal” in their sector or industry, and consolidation along with the hunt for innovation. (See Exhibit 2.)

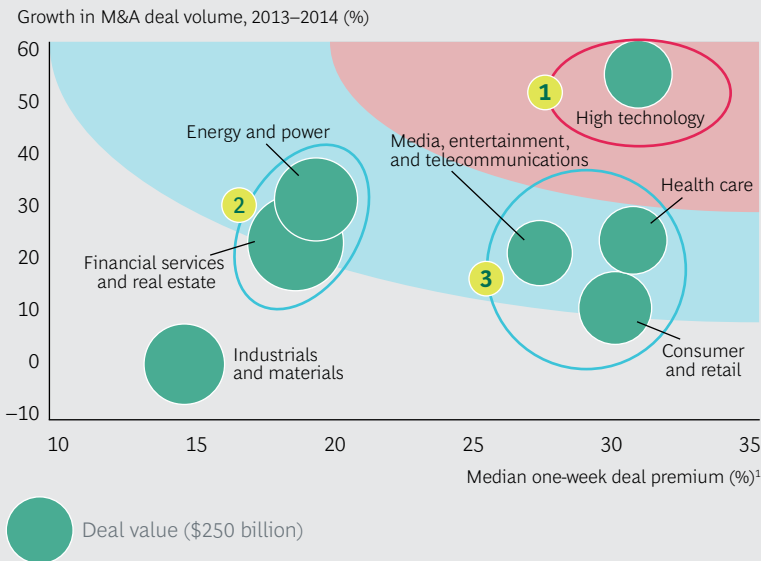
**Hot High-Tech Markets.** The superheated high-tech sector saw the largest increase in deal value and the biggest deal premiums. Technology companies are on the lookout for portfolio add-ons to expand their capabilities and customer base, and some nontech

companies are seeking diversification in order to participate in the high-tech growth story. Google, for example, completed more than 30 deals in 2014 involving a wide range of technologies—including Nest Labs (which makes in-home HVAC controls) and Skybox Imaging (a satellite-imaging company). Daimler expanded its technology capabilities with the purchase of Intelligent Apps (parent company of mytaxi) and RideScout, which compete with Uber in the fast-growing—and sometimes controversial—ride-sharing business. Takeover premiums as high as 31 percent—on top of already healthy share-price valuations—clearly showed high tech to be the hottest M&A market in 2014, with growth as its common theme.

**Adapting to a New Normal.** In the energy and financial services sectors, companies are using M&A to adapt to changed environments. The large and sudden fall in oil prices—driven by big increases in world supply and the battle between Persian Gulf producers and nimble new North American shale and fracking companies—has caused a

## EXHIBIT 2 | Three Global Trends Defined M&A in 2014

### THREE PRIMARY INDUSTRY M&A TRENDS



Sources: Thomson ONE Banker; BCG analysis.

Note: The size of each bubble represents the sum of deal values in each industry in 2014.

<sup>1</sup>The median one-week deal premium covers all transactions with listed targets in 2014.

### STATE OF THE WORLD

- 1 **Hot high-tech markets**
  - High-tech companies on the lookout for portfolio add-ons to increase their customer base
  - Nontech companies diversify in order to participate in the high-tech growth story
- 2 **Adapting to a new normal**
  - Deals in energy and financial services drive the hunt for scale in a low-growth, post-Fukushima, and low-interest environment
  - Lower deal premiums reflect the need to sell and challenging market conditions
- 3 **Consolidation and the hunt for innovation**
  - Externalized R&D drives health care M&A
  - Consumer acquirers on the lookout for innovations to address changing customer demand
  - Deals made in order to gain scale in technology, media, and telecommunications

sea change in the industry. Energy companies need to reposition themselves in a new marketplace, defined by oil in the \$40- to \$70-a-barrel price range, rather than \$100 to \$120 a barrel. The November 2014 Halliburton–Baker Hughes deal is one example in oil field services. Repsol’s acquisition of Talisman Energy and Encana’s acquisition of Athlon Energy are examples of upstream oil companies expanding their production base.

At the same time, many power companies continue to struggle, post-Fukushima, to find alternatives for their highly profitable nuclear-power business. Two acquisitions valued at more than \$1 billion each in Asia point to the rising importance of renewable energy sources. In India, JSW Energy acquired two hydroelectric projects in a \$1.6 billion deal. While in China, Wuhan Kaidi Electric Power acquired 87 biomass power stations, five wind-power projects, and three hydroelectric installations for \$1.1 billion.

As oil prices have dropped, private-equity firms—which have long been enthusiastic about the energy sector—seem undeterred by mixed results from their energy investments and are becoming increasingly active.

We expect deal activity to continue to be strong but premiums to remain muted as they were in 2014. M&A is as much a tool for survival as expansion in the current environment.

A similar shift to changed circumstances is taking place in financial services, thanks to the extended period of low interest rates following the 2008 financial crisis. Banks and other financial-services institutions are using M&A to strategically expand their footprints where they see opportunity. For example, Swedbank acquired Sparbanken Öresund to form Sweden’s largest savings bank. Multiple acquirers in the U.S. snapped up regional banks over the course of 2014. At the same time, big players such as General Electric decided to divest their financial-services operations. While these types of deals fueled the M&A pipeline with volume growth of 31 percent in 2014 over 2013, average acquisition premiums dropped by 19 percent.

**Consolidation and the Hunt for Innovation.** In health care, consumer goods, and media, entertainment, and telecommunications, many companies are on a hunt for innovation through acquisition, while others seek scale

and enhanced market position. Within the pharmaceutical industry, M&A has become a form of what might be called externalized R&D—companies acquiring smaller enterprises with a promising new product or process early in the development stage. At the same time, large-cap players looking to generate sales synergies are acquiring market-ready innovations that are in an advanced state. In August 2014, for example, Roche agreed to acquire InterMune, a biotech company that develops drug treatments for pulmonary and fibrotic diseases, for \$8.3 billion. AbbVie’s \$21 billion agreement to buy Pharmacyclis, Pfizer’s \$17 billion acquisition of Hospira, and Valeant’s \$11 billion deal to acquire Salix propelled these trends into 2015 with a full head of steam behind them.

Deals such as these are often big, costly, and complex. But large players need products to feed their global sales networks, and their networks can better market established drugs than the sales networks of the smaller companies that develop the drugs. There is significant upside for the acquirer, despite high prices and premiums.

In the mature and competitive consumer and retail sector, acquirers such as Suntory (which acquired Beam), Tyson Foods (which acquired Hillshire Brands), Anheuser-Busch In-

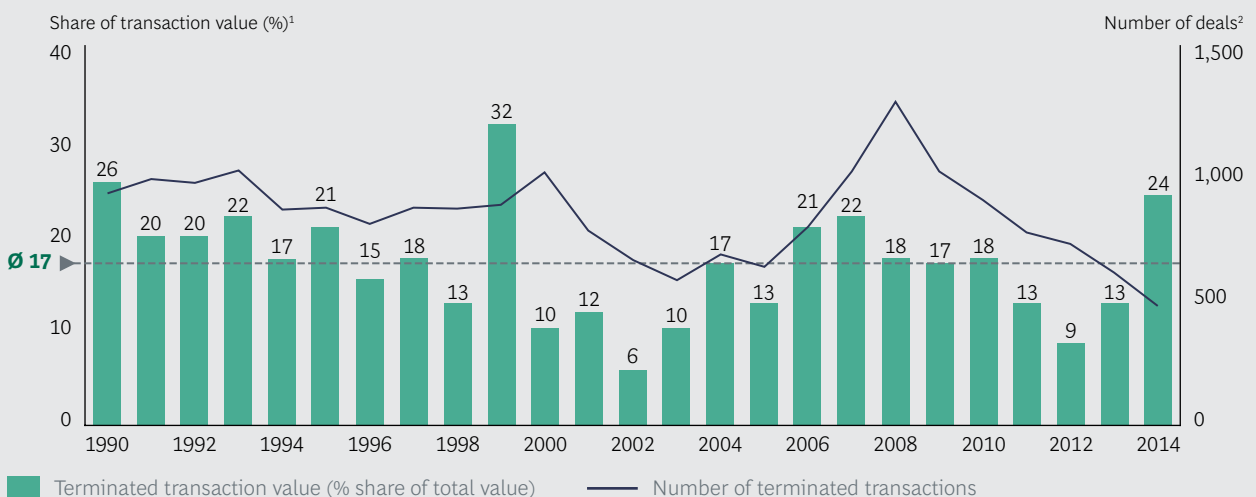
Bev (which acquired Oriental Brewery) and Dollar Tree (which acquired Family Dollar Stores) clearly believe that buying established brands is both less expensive and more certain than trying to build them, both at home and internationally. Similarly, media and telecom companies such as Charter Communications and Numericable sought scale and market share with bids for Time Warner Cable and Bouygues Telecom, respectively.

## The Year That Could Have Been Much Bigger

The year 2014 might be remembered as much for the deals that didn’t happen as for those that did. Unsuccessful or terminated takeover attempts reached their highest level since 1999. (See Exhibit 3.) Almost a quarter of announced deal value failed to reach consummation, owing primarily to unsuccessful megadeals, such as 21st Century Fox’s bid for Time Warner Inc. and Pfizer’s offer to acquire AstraZeneca. In fact, three offers aggregating almost \$300 billion—some 15 percent of the year’s total deal value—were withdrawn or terminated.

The high failure rate may be rooted in the fact that megadeals are inherently more complex and difficult to complete than smaller transactions. Their size means they often reshape in-

**EXHIBIT 3 | Failed Megadeals Cut 2014 Deal Value by Almost 25 Percent**



Sources: Thomson ONE Banker; BCG analysis.

<sup>1</sup>The share of transaction value is based on the total deal value of both completed and pulled deals; values include the net debt of targets.

<sup>2</sup>The total number of deals includes 18,861 pulled M&A transactions, with no transaction-size threshold, and excludes repurchases, exchange offers, recapitalizations, and spin-offs.

dustry landscapes, which can engender both strong opposition from the target’s management and greater scrutiny from regulatory authorities. The managements and boards of both Time Warner Inc. and AstraZeneca refused to be led to the altar. Antitrust concerns were raised by Time Warner Cable’s management in the face of the Charter bid. And the public and political outcry over inversion deals played a big role in the demise of two failed pharmaceutical-industry bids (Pfizer for AstraZeneca and AbbVie for Shire). Meanwhile, many smaller deals moved forward to completion without opposition or objection.

The irony is that, in 2014 at least, investors might well have missed opportunities to profit on both ends of these transactions. With average excess returns of 0.6 percent for acquirers and returns of 19 percent (at announcement) for targets, 2014 was one of those rare years in which M&A resulted in net gains for shareholders of both acquirers and targets. Long-term historical averages show the benefits of M&A accruing heavily to the target company’s shareholders, while the acquirer’s shareholders, more often than not, lose money. (See Exhibit 4.) Last year, we reported that 60 percent of respondents to BCG’s 2014 Investor Survey favored a more aggressive approach to M&A, and investors’ responses to deals since then have borne out their enthusiasm.

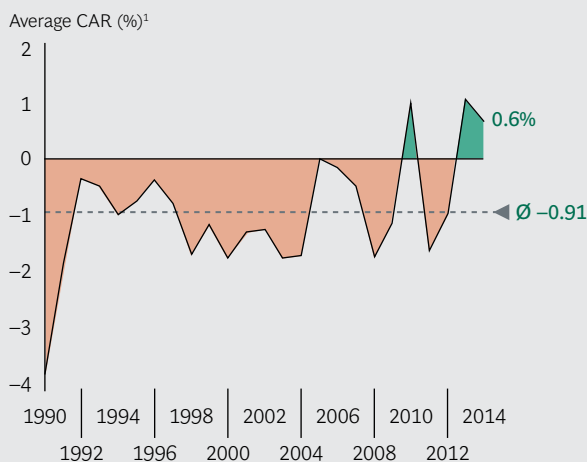
## Will Deal Volume and Value Continue to Rise?

Median enterprise-value-to-EBITDA multiples have been on the increase since 2009. They stood at 12.3 in 2014, above the 25-year average of 12.0, and are closing in on 2007 record territory of 13.7. Acquirers are buying at lofty price levels. At the same time, average take-over premiums of 27.7 percent in 2014 are still about 4 percentage points below their longtime average of 32 percent and well below the mid- to upper-30 percent premiums that have been paid in recent years. This suggests that the current M&A bull market might have additional room to run, although one has to question whether the pace of activity in the first half of 2015 is sustainable. (See Exhibit 5.)

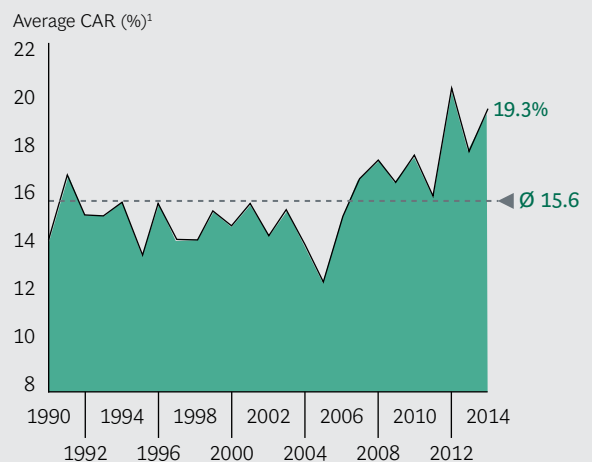
Other factors point to continued strength. Interest rates remain low, credit is readily available, and buyers are willing to borrow. The debt-to-equity levels of the leveraged buyout deals today are similar to those before the financial crisis; the average leveraged buyout in 2014 included 36.9 percent equity, slightly above the 35.6 percent equity in 2013. “Covenant lite” loan activity in 2014 also continued at record levels. The incidence of these loans, which generally do not involve any maintenance covenants, indicates growing investor appetite in the leveraged-loan market, mak-

### EXHIBIT 4 | Both Acquirers and Sellers Earned Positive Returns in 2014

ACQUIRERS’ PERFORMANCE  
(PUBLIC-TO-PUBLIC DEALS)



TARGETS’ PERFORMANCE  
(PUBLIC-TO-PUBLIC DEALS)

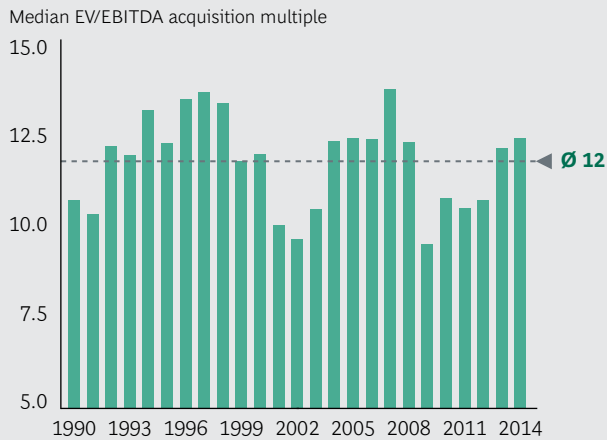


Sources: Thomson Reuters Datastream; Thomson Reuters Worldscope; BCG analysis.

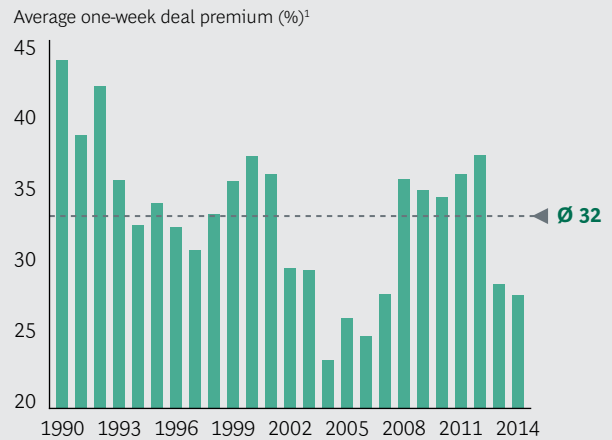
<sup>1</sup>CAR = cumulative abnormal return; it is calculated over a seven-day window centered around the announcement date (+3/-3).

## EXHIBIT 5 | Valuations Near All-Time Highs While Deal Premiums Remain Low

VALUATION LEVELS ARE BACK AT PRECRISIS LEVELS . . .



. . . WHILE DEAL PREMIUMS REMAIN BELOW HISTORICAL AVERAGES



Sources: Thomson ONE Banker; BCG analysis.

<sup>1</sup>The acquisition premium is the amount by which the offer price exceeds the target's closing stock price one week before the original announcement date; the top 2.5 percent of deals were excluded to reduce distortion by outliers.

ing borrowing even more attractive for private-equity deals.

In addition, many market participants have substantial and growing resources that they need to put to work. The number of private-equity deals rose 16 percent in 2014 to a record 4,590, while the value of these transactions jumped 18 percent to almost \$550 billion—both big increases compared with the past few years. Private-equity transactions represented almost 20 percent of the total number of M&A deals in 2014, up from 17.5 percent in 2013. Cash available in private-equity funds reached \$462 billion in February 2015, an increase of 7 percent over year-end 2013 and approaching record levels. (See Exhibit 6.)

As always, a big challenge for private-equity investors is finding attractive acquisition opportunities. Rising asset valuations cut into potential returns, and corporate owners have become much better in recent years at applying private-equity-like discipline and practices across their operations, leaving less room for new owners to make improvements. That said, as we pointed out last year, divestitures have been on the rise as a means of creating value on both sides of M&A transactions. In industries undergoing transition, such as energy and financial services, the divestitures represented 57 percent and 46 percent, re-

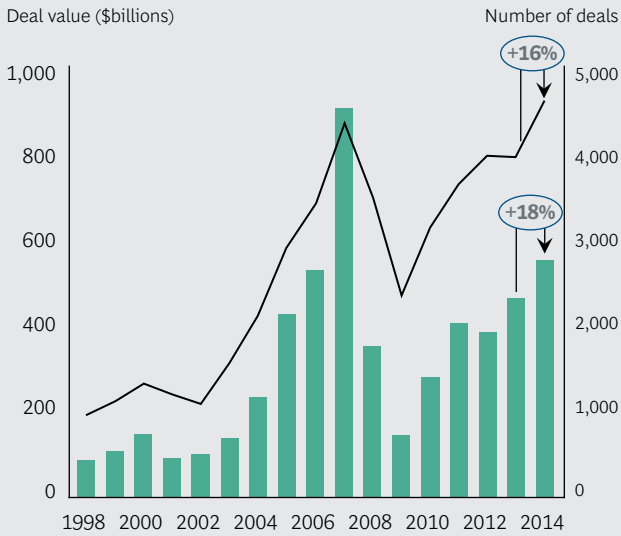
spectively, of all deals in 2014. Private-equity firms are frequent buyers of such assets.

For corporate acquirers, several key indicators would also point to further deal activity. Cash reserves remain at record highs, and public-company investors, like their private-equity counterparts, become impatient when money is not put to productive use. Companies are not raising dividends—both gross payouts and payout ratios have been flat or declining in recent years. Corporate capital expenditures, in both dollar terms and as a percentage of sales, have also plateaued. (See Exhibit 7.) M&A is one of a few remaining strategic alternatives, especially for companies seeking growth.

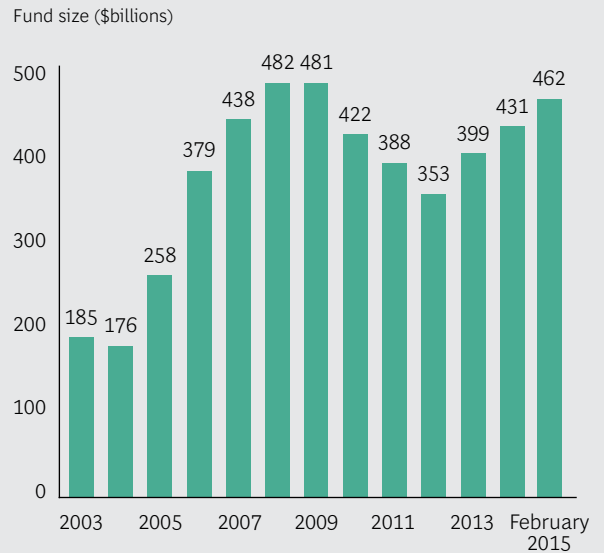
The search for growth—the subject we explore in this year's report—may be the pivotal imperative. Organic growth is hard to come by when the rates of projected economic expansion are low in most markets and many sectors. This will cause some, perhaps many, managements to cast their eyes externally—toward others in their industries or to adjacent business sectors. This can be a smart strategy. But as we show in the following chapters, acquiring one's way to growth is a complex undertaking that is by no means assured of achieving its goals. Careful planning, precise execution, and a hard-nosed assessment of the capital markets are all prerequisites for success.

## EXHIBIT 6 | Private-Equity War Chest Approaches Record Levels

DEVELOPMENT OF PRIVATE-EQUITY ACTIVITY<sup>1</sup>



PRIVATE-EQUITY DRY POWDER ON A STEADY RISE<sup>2</sup>



— Number of deals    ■ Value of deals

Sources: Thomson ONE Banker; Preqin; BCG analysis.

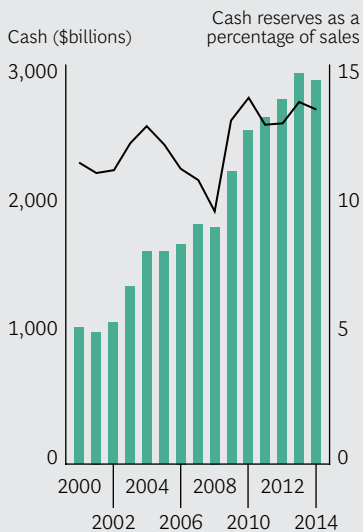
Note: In the right-hand graphic, each bar represents data on December 31 of the year noted, with the exception of 2015, for which data are available only through February 28.

<sup>1</sup>This analysis is based on completed deals, including transactions involving at least 75 percent of shares being acquired.

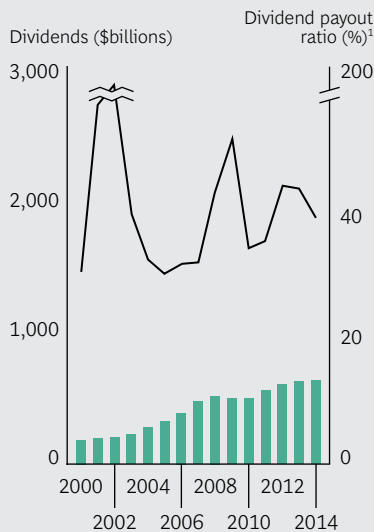
<sup>2</sup>Amounts include buyout funds only.

## EXHIBIT 7 | Corporate Cash Reserves at Record Highs While Spending Stagnates

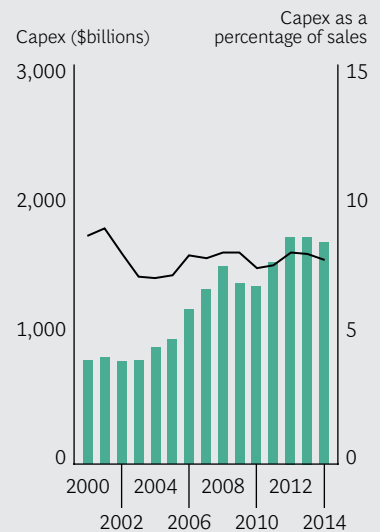
INCREASING CORPORATE CASH RESERVES



DECLINING DIVIDEND PAYOUT RATIO



MODERATE CAPITAL EXPENDITURE



■ Corporate cash reserves  
— Cash reserves as a percentage of sales

■ Dividend payouts  
— Dividend payout ratio

■ Capital expenditures  
— Capex as a percentage of sales

Sources: Capital IQ; BCG analysis.

Note: This analysis excludes companies in the financial services industry and companies for which sufficient data are not available after the year 2000. The total number of companies included in the sample is 840.

<sup>1</sup>Payout ratio is defined as total dividends paid to stockholders relative to a company's net income.

# SHOULD COMPANIES BUY GROWTH?

**G**ROWTH IS A KEY driver of shareholder value. For high performers, say the top-quartile value creators of the S&P 500, growth creates twice as much value as margin or cash flow improvement. Yet most companies—those that lack the tailwinds of a hot industry such as technology—must “grow uphill,” facing maturity and commoditization (which erode advantage) or disruption and changing customer behaviors (which erase it). (See “Growth for the Rest of Us,” BCG Perspectives, January 2014.) One question is: Can companies buy their way to growth? Or, put another way, do acquisitive companies grow faster than those that avoid acquisitions?

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Over the long term, do acquisitive companies grow faster than nonacquirers?

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Economists and other experts have long debated whether acquisitions create value. The most oft-cited statistic—which has become almost a corporate rule of thumb—is that acquisitions destroy value, at least in the short term, in more than half to two-thirds of all cases. Business leaders who participated in our 2015 Corporate Leaders M&A Survey confirmed that this has indeed been the case for

their companies. (See “Why Deals Fail,” BCG article, October 2015.) In-depth research on the impact of acquisitions on growth is harder to come by, however. Using our proprietary database, which includes more than 40,000 transactions that have taken place since 1990, we set out to examine just this impact. We asked three questions:

- Do acquisitive companies grow faster than nonacquisitive companies in the long term? While it is easy enough to buy a short-term revenue boost, over a 25-year time horizon, does a dollar spent on acquisitions yield a higher growth rate than a dollar spent on organic capital expenditure?
- To what extent can profitable bottom-line growth be achieved from acquisitions? Again, buying top-line growth is a straightforward task. But covering integration costs and realizing the synergies that generate growth for the bottom line is far more complex.
- Does acquiring growth actually generate value for shareholders? (See the chapter “From Acquiring Growth to Growing Value.”)

The results are both eye opening and instructive for any company considering acquisitions as part of its growth strategy. They are partic-



ularly relevant for companies in mature industries such as industrial goods, financial services, and media and telecommunications. Companies in such industries, which have evidenced low or no organic growth in recent years, are far more likely to be buyers in M&A transactions, as they depend more on growth through acquisition. Companies in higher growth sectors, such as health care and technology, are much more often sellers. (See Exhibit 8.)

### Buying Long-Term Growth

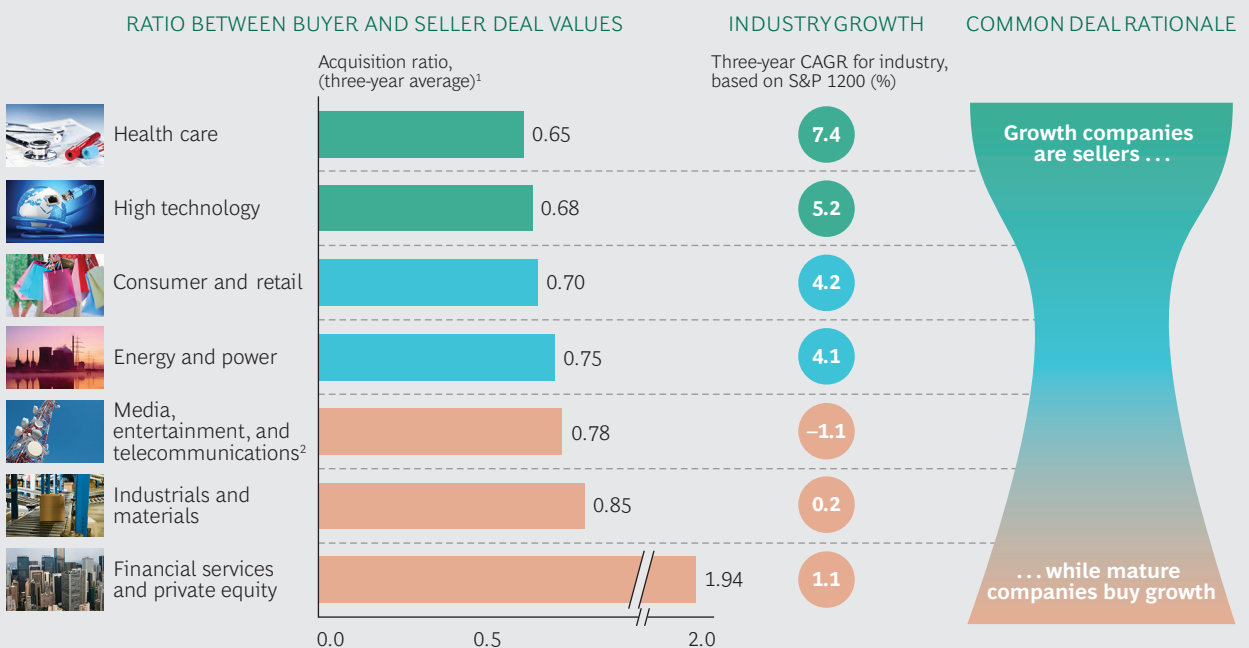
As one might expect, companies that make acquisitions have higher short-term revenue growth rates than those that do not—8.3 percentage points higher in a typical five-year period. Not surprisingly, the more acquisitions a company makes, the higher its rate of revenue growth—17 percent a year for those making one to two acquisitions over a five-year time frame, and 23 percent for those doing more than five deals. (See Exhibit 9.) (To get a balanced sense of the impact of acquisitions over time, we analyzed compound average revenue growth rates over rolling

five-year periods from 1990 through 2014 (20 five-year windows) for 10,395 companies. This translates into approximately 208,000 data points, which consist of 37 percent M&A activity and 63 percent non-M&A activity observations.

A bit less obvious: acquisitive companies also grow faster over the long term—25 years or more. Companies that made acquisitions grew a full percentage point faster each year from 1990 through 2014 (6 percent a year compared with 5 percent) than those that spent their cash fostering nonacquisitive growth through capital expenditures and other investments. The average acquisitive company in our sample generated some \$900 million in additional annual revenue after 25 years (on a sales base of \$3.27 billion a year). (See Exhibit 10.)

To be sure, a lot depends on the individual company, as well as its circumstances and decisions. Companies can make good or not-so-good investment decisions, just as they can make successful or unsuccessful acquisitions. But, if revenue growth is a goal, acquisitions

## EXHIBIT 8 | Industry Maturity Is a Key Driver of Acquisition Activity



Sources: Thomson ONE Banker; Capital IQ; BCG analysis.

Note: Deal values are expressed in millions of (U.S.) dollars and based on a three-year average for the years 2012 through 2014.

<sup>1</sup>The acquisition ratio is calculated as follows: total deal value when companies from the industry are the acquirers relative to the total deal value when companies from the industry are the targets.

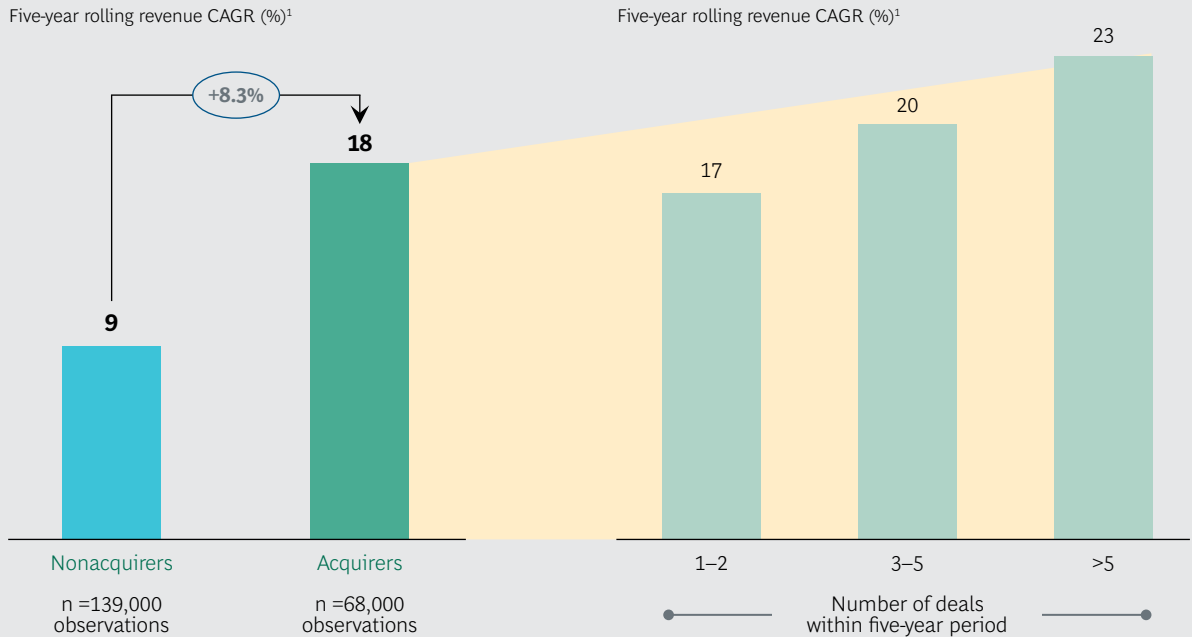
<sup>2</sup>The media, entertainment, and telecommunications acquisition ratio is calculated for the years 2013 and 2014.



## EXHIBIT 9 | Acquisitions Enhance Top-Line Growth

IN THE SHORT TERM, ENGAGING IN M&A LEADS TO SIGNIFICANT TOP-LINE GROWTH ...

... AND THERE IS A CLEAR RELATIONSHIP BETWEEN THE NUMBER OF ACQUISITIONS AND GROWTH



Sources: Thomson Reuters Datastream; Thomson ONE Banker; BCG analysis.

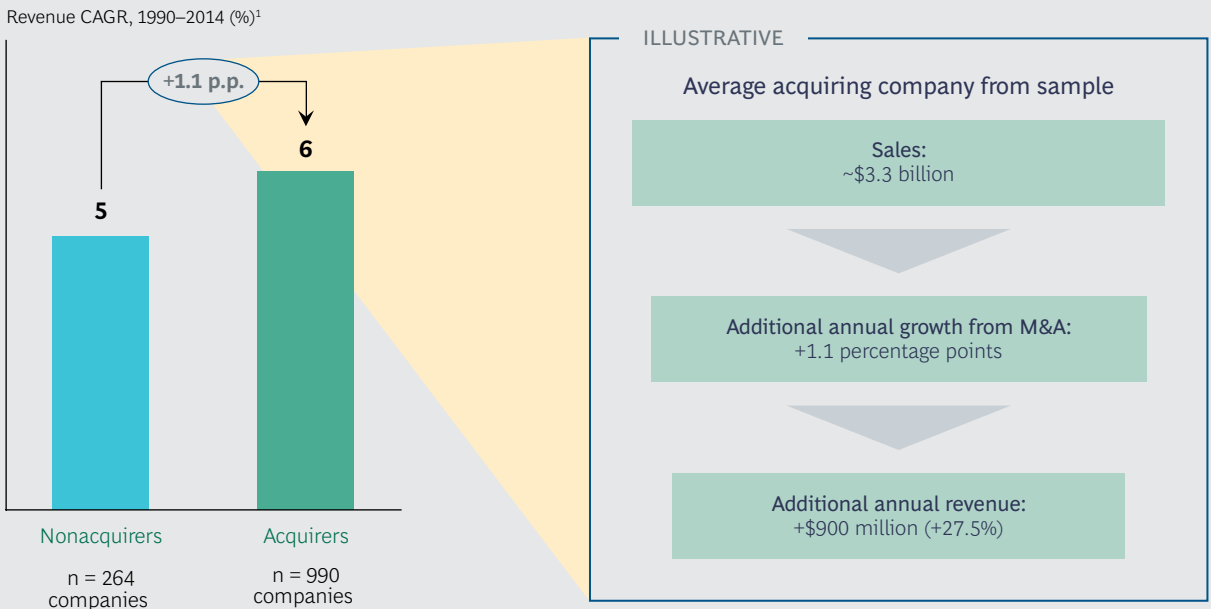
Note: This analysis excludes companies from the financial services industry.

<sup>1</sup>We analyzed revenue CAGR in rolling five-year periods from 1990 through 2014 for 10,395 companies, creating approximately 208,000 distinct observations.

## EXHIBIT 10 | Marginal Difference in Sales Growth Has Big Long-Term Impact

IN THE LONG RUN, ACQUISITIVE COMPANIES GROW MORE QUICKLY ...

... AND THIS GROWTH HAS A SUBSTANTIAL EFFECT OVER A 25-YEAR PERIOD



Sources: Thomson Reuters Datastream; Thomson ONE Banker; BCG analysis.

Note: This analysis excludes companies from the financial services industry.

<sup>1</sup>We analyzed revenue CAGR in rolling five-year periods from 1990 through 2014.

can be a more effective way to achieve it than organic capital expenditures—especially for those companies with track records of M&A experience.

## Growth for the Bottom Line

But what about the value generated by that acquired growth? Let's look at profitability first. Acquirers buy an EBITDA stream along with revenues. But increasing EBITDA over time is a much more complex task. Big issues, such as the respective margins of buyer and target and postmerger integration (PMI), come into play.

Our analysis shows that nonacquisitive companies increased EBITDA at the same rate as they increased sales—an average of 9 percent. Acquirers increased EBITDA faster—an average of 15 percent—and, once again, the more companies they acquired, the faster the absolute earnings increased (up to 22 percent for companies that made more than five acquisitions in a five-year period). But, interestingly, the growth in EBITDA was, on average, slower than the growth in sales

by 1 to 3 percentage points (again, depending on the number of acquisitions made). (See Exhibit 11.)

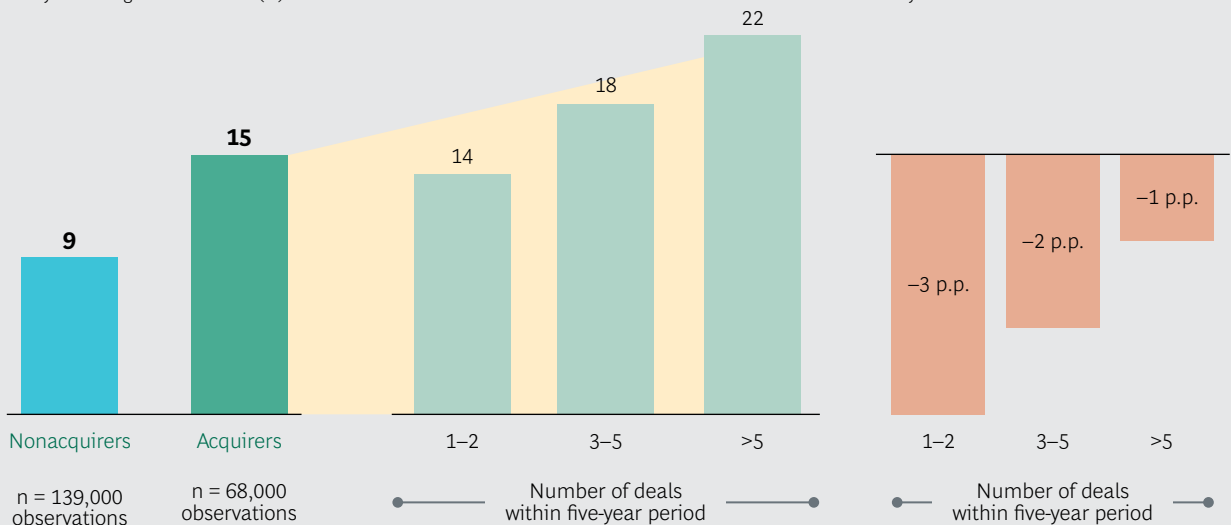
Translating organically generated top-line growth into profit is generally a straightforward matter of managing costs and productivity effectively. As we explore in the next chapter, profiting from acquisitions—even when a good (high margin) target is selected—means managing the integration of the two companies well. This is something that relatively few companies (other than the ones that acquire frequently and strategically) are good at. In 60 percent of the cases in our sample, the target's margin was significantly lower than that of the acquirer—on average 2.1 percentage points lower, a tough deficit to make up. In addition, over the years following an acquisition, the margin of the acquirer declines, even for experienced acquirers. (See Exhibit 12.) This raises a question: Do the synergies acquirers often point to as justification for a deal actually materialize? (See *Divide and Conquer: How Successful M&A Deals Split the Synergies*, BCG Focus, March 2013.)

### EXHIBIT 11 | Increasing EBITDA with Acquisitions Is a Complex Task

WHILE ACTIVE ACQUIRERS INCREASE THEIR EBITDA ...

... THIS COMES AT LOWER RATES THAN TOP-LINE GROWTH

Five-year rolling EBITDA CAGR (%)<sup>1</sup>



Sources: Thomson Reuters Datastream; Thomson ONE Banker; BCG analysis.

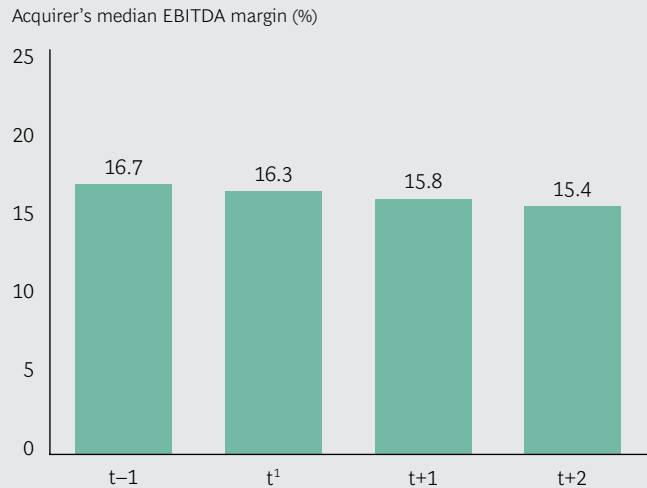
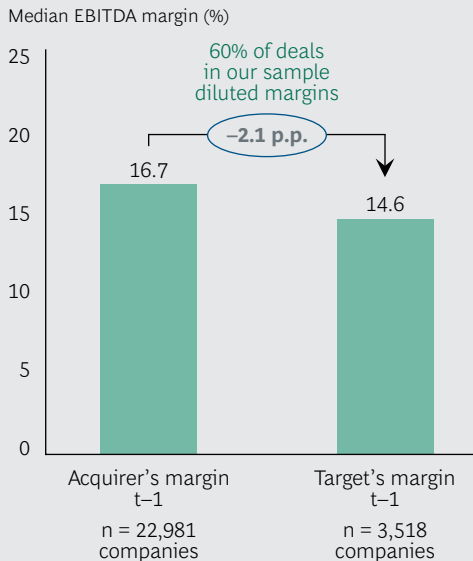
Note: This analysis excludes companies from the financial services industry.

<sup>1</sup>We analyzed EBITDA CAGR in rolling five-year periods from 1990 through 2014 for 10,395 companies, creating approximately 208,000 distinct observations.

## EXHIBIT 12 | The Average Acquisition Dilutes Margins

TARGETS, ON AVERAGE, HAVE LOWER PROFITABILITY

AFTER AN ACQUISITION, THE ACQUIRER'S MARGIN SHRINKS



Sources: Thomson Reuters Datastream; Thomson ONE Banker; BCG analysis.

Note: This analysis excludes companies from the financial services industry. Outliers were winsorized by setting them to the 99th and 1st percentile, respectively.

<sup>†</sup>t is the date of the acquisition announcement.

The results do show, however, that as with revenue growth, the more experienced the acquirer, the better its chances of overcoming the margin challenge. These companies are often better able to achieve profitable growth from acquisitions, in large part because of their willingness to invest large amounts of leadership time, money, and organizational focus in support of their M&A strategy—in advance of any particular deal. For these serial acquirers, each completed transaction is often the result of years, or even decades, of consistent, patient, and methodical preparation. (See “Unlocking Acquisitive Growth: Lessons from Successful Serial Acquirers,” BCG Perspectives, October 2014.)

M&A involves minefields and pitfalls, and the challenges companies face are not necessarily proportional to the size of the transaction. A company may well need to devote more resources and attention to a small deal in an emerging market than to a far larger transaction in its home market because cultural and market differences complicate integrating the two companies’ businesses, which is prerequisite to realizing synergies. Many acquisitions fail to realize their potential—and plenty just

flat out fail—even in high-growth markets because of unsuccessful PMI, which can result not only in lost synergies but also in damaging misunderstandings between the acquiring company and the target. (See *M&A in China: Getting Deals Done, Making Them Work*, BCG Focus, January 2015.)

Companies can indeed acquire their way to growth. But neither growth nor value creation is assured, and achieving either one through acquisition is tough—especially for those companies that are relatively inexperienced. The next chapter explores the factors any company trying to acquire growth and value needs to consider.

# FROM ACQUIRING GROWTH TO GROWING VALUE

**R**ESearch, including our own, repeatedly shows that acquisitions more often than not destroy value. (See *Riding the Next Wave in M&A: Where Are the Opportunities to Create Value?*, BCG report, June 2011.) Yet companies continue to acquire, each secure in the belief, apparently, that it can buck the trend.

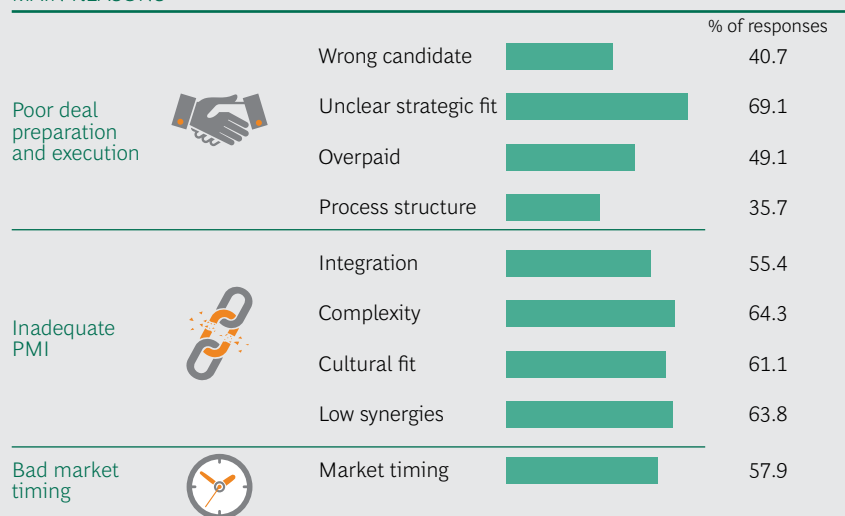
When we asked corporate leaders why their acquisitions do fail or do not deliver the expected value, the most often-cited reasons fell

into three categories: poor deal preparation and execution (including target selection and strategic fit); inadequate PMI; and bad market timing. (See Exhibit 13.)

These results and our own experience working with many clients on acquisition strategy and execution point to three considerations that acquirers must keep front and center if they are to create value: cast a wide net, but prepare to seize opportunity; effective PMI is imperative; and timing and communication matter.

## EXHIBIT 13 | Corporate Leaders Cite Three Main Reasons for Failed Acquisitions

### MAIN REASONS



### KEY TAKEAWAYS

- 1 Cast a wide net, but prepare to seize opportunity
- 2 Effective PMI is imperative
- 3 Timing and communication matter

**Sources:** BCG 2015 Corporate Leaders M&A Survey; BCG analysis.

**Note:** A total of 54 corporate leaders responded to this survey question; respondents could cite multiple reasons for failed acquisitions.

## Cast a Wide Net, but Prepare to Seize Opportunity

Acquiring companies are selective—as they should be. Our research shows that the average acquirer reviews roughly 20 candidates before closing a deal, eliminating high percentages of potential targets at each stage of the review process before finally making a binding offer. There is good reason. The two reasons for failed acquisitions most cited by respondents to our 2015 Corporate Leaders M&A Survey were unclear strategic fit and lower than expected synergies. Acquirers ought to be able to surface both of these issues with a disciplined review and selection process. On the basis of our experience with corporate acquirers, we recommend that the following five principles guide the target selection process:

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PMI is one of the most difficult challenges that senior executives face.

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- Take a step back before you start; understanding key industry dynamics is critical. Begin with a sound analysis of your industry and understand the factors influencing direction for the next five to ten years.
- Don't pursue M&A without a strategy. A sound portfolio analysis is the starting point for a target search. Decide which are the growth businesses in your portfolio, and prioritize your search accordingly.
- Follow a systematic approach and focus efforts on quantifiable value creation. Pay particular attention to the strategic fit between candidate and acquirer and the feasibility of a deal.
- Be rigorous—shortcuts don't pay off. Make sure you have a disciplined analytical approach, and that you invest the requisite time to analyze targets in depth.
- Embed the target search process in your organization. M&A is not a one-time

effort. Approach the target search as an opportunity to set up a permanent screening process for future acquisitions.

One word of caution, however. The process should not be so rigid—or so rigidly adhered to—that it actually hinders the buyer from moving quickly and opportunistically when an attractive prospect presents itself. A surprising finding of our research is that extensive selection does not by itself guarantee success—or vice versa. Companies that consider and reject relatively few candidates—an elimination rate of 20 percent or less—have a better success record than those that cast a very wide net before narrowing the field. (See Exhibit 14.)

## The PMI Imperative

The four reasons most cited by corporate leaders for failed acquisitions involve what happens after a deal closes: integration, complexity, cultural fit, and low synergies. As we have written before, many companies struggle to integrate fully after the deal. Synergy targets that were so enticing in the run-up to the deal melt away under the realities of meshing two often very different organizations in a short time. (See *Enabling PMI: Building Capabilities for Effective Integration*, BCG Focus, July 2012.)

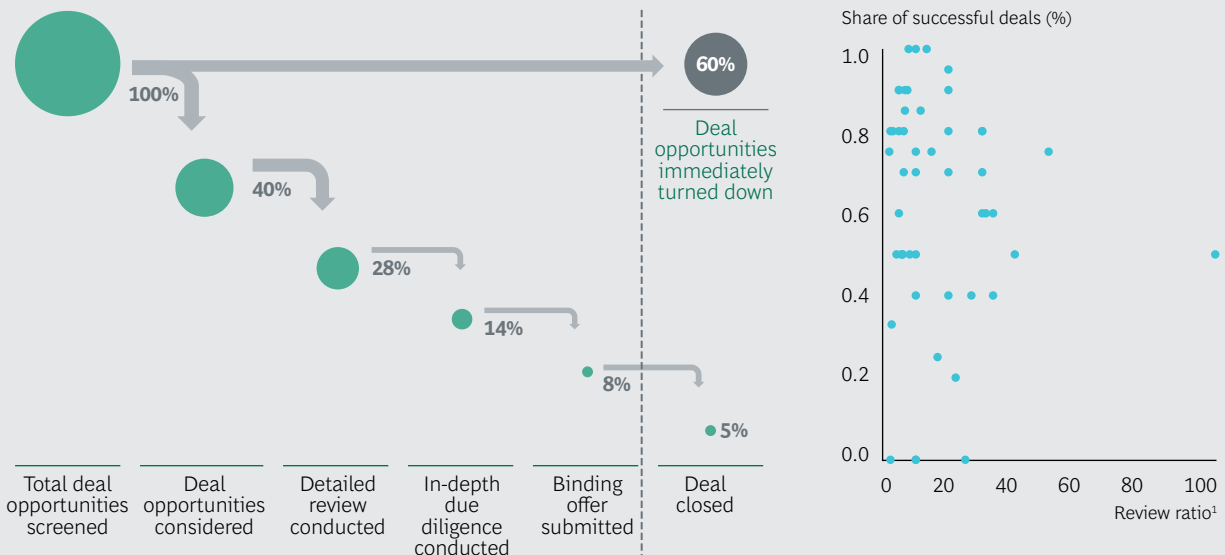
This should not be surprising. For the vast majority of companies, acquisitions are infrequent events. In a typical year, three-quarters or more of the deals executed involve acquirers that have made one acquisition or no acquisitions in the previous five years. At the same time, PMI is one of the most difficult challenges that senior executives face. It is a complex undertaking, often involving multiple simultaneous changes in a company's business processes, organization structure, and management personnel. Bringing together two organizations, each with its own culture, norms, and behaviors—while protecting day-to-day cash flow—is a corporate mission unlike most others.

Adding to the challenge is the need for speed. Investors typically expect to see cost synergies delivered rapidly—within 12 to 36 months of a deal being signed. They know

## EXHIBIT 14 | A Broad Selection of Targets Does Not Improve the Success Rate

THE AVERAGE DEAL-ASSESSMENT PROCESS IS VERY SELECTIVE . . .

. . . BUT THE BREADTH OF THE FIELD DOES NOT NECESSARILY IMPROVE SUCCESS RATES



Sources: BCG 2015 Corporate Leaders M&A Survey; BCG analysis.  
 Note: A total of 49 corporate leaders responded to this survey question.  
<sup>1</sup>The review ratio is the number of deals considered for every deal completed.

that the longer PMI takes, the less likely that synergies will be achieved and the more probable that problems will emerge.

And while most executives believe that they are quite aware of how to integrate properly, and they stand ready to devote the necessary resources to making sure PMI gets the attention it requires, they often find that they either overestimated their preparedness or underestimated the challenges. In most organizations PMI is not a core skill. It requires considerably different talents and capabilities than conventional line management, and every situation is different. The approach a company takes to a particular integration depends substantially on the strategic rationale for the merger and the circumstances of the two companies involved.

Capital markets understand this phenomenon all too well, and if they are skeptical of promised synergies, they are equally quick to punish inexperienced acquirers that do not deliver. Deals done by “one-timers” (companies that make only one acquisition in a five-year period) generate an average relative total shareholder return (RTSR) of only 2 per-

cent in the first year after the announcement date, and only 43 percent of such deals generate a positive shareholder return. Because so many deals involve one-time acquirers, they drag down the overall averages—the typical deal generates an RTSR of only 4 percent, and only 47 percent of all deals perform above this mark. (See Exhibit 15.)

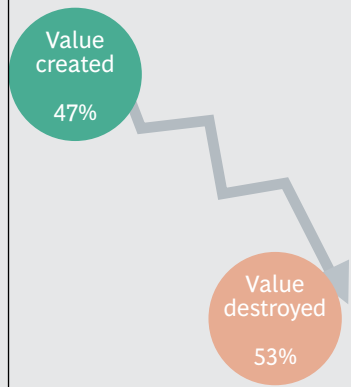
By contrast, more experienced acquirers, which include active buyers (two to five deals in a five-year period) and portfolio builders (more than five deals in five years), receive much better capital-market treatment. They generate average one-year RTSRs of 6 percent and 8 percent, respectively, and more than half of all deals involving these acquirers (51 percent for active buyers and 56 percent for portfolio builders) generate positive returns for their shareholders.

The data show why—in M&A, practice makes perfect (or close enough). Strategic acquirers that make regular acquisitions enhance value for their shareholders. They do this over multiple reference periods—5, 10, and 25 years. Active buyers and portfolio builders achieve annual TSR rates substantially higher

## EXHIBIT 15 | One-Time Acquirers Drag Down the Deal Success Averages

ON AVERAGE, MORE THAN 50 PERCENT OF ALL ACQUISITIONS DESTROY VALUE

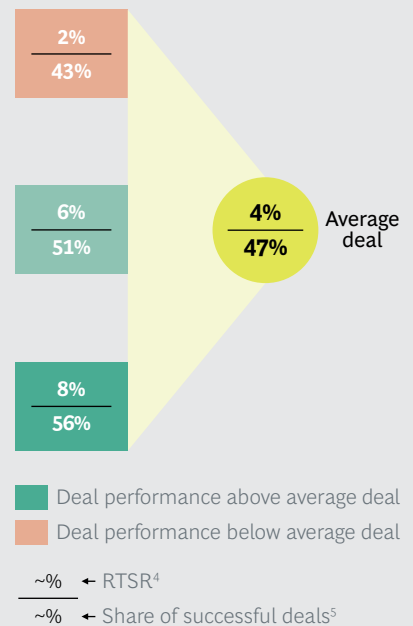
First-year RTSR on completed acquisitions (%)



THERE ARE THREE BASIC TYPES OF ACQUIRERS . . .

- 1 **One-timers<sup>1</sup>**  
Acquire rarely (if opportunity arises) — acquisitions are not an active part of strategy
- 2 **Active buyers<sup>2</sup>**  
Selectively fill gaps through focused M&A and execute deals on a regular basis to strengthen portfolio
- 3 **Portfolio builders<sup>3</sup>**  
Consolidate within industry or expand into new territories through serial acquisitions

. . . AND EACH YIELDS DIFFERENT SHAREHOLDER RETURNS



**Sources:** Thomson Reuters Datastream; Thomson ONE Banker; BCG analysis.

**Note:** This analysis is based on 37,299 transactions from 1990 through 2014.

<sup>1</sup>One-timers made 1 acquisition within the 5-year period, 1 to 2 acquisitions within the 10-year period, and 1 to 5 acquisitions over the 25-year period observed.

<sup>2</sup>Active buyers made 2 to 5 acquisitions within the 5-year period, 3 to 10 acquisitions within the 10-year period, and 6 to 25 acquisitions over the 25-year period observed.

<sup>3</sup>Portfolio builders made more than 5 acquisitions within the 5-year period, more than 10 acquisitions within the 10-year period, and more than 25 acquisitions over the 25-year period observed.

<sup>4</sup>RTSR = relative total shareholder return one year after the announcement date.

<sup>5</sup>The share of successful deals includes the percentage of deals in each category with a positive RTSR.

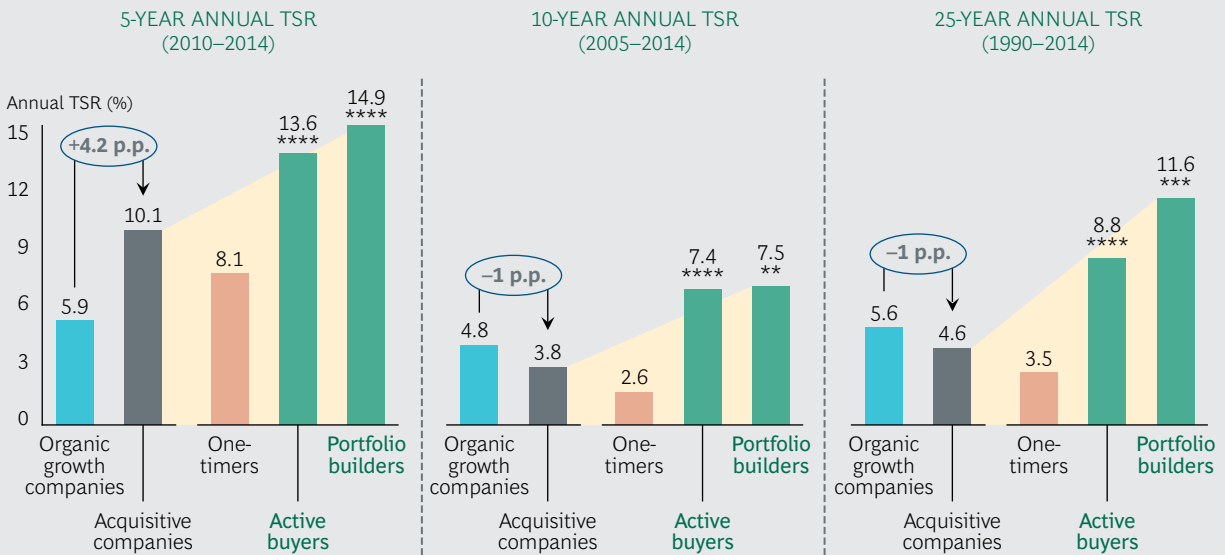
than those achieved by one-timers—and also much higher in all instances than companies pursuing only organic growth. (See Exhibit 16.)

It should be noted that capital markets are not adverse to one-time acquisitions—quite the opposite, in fact. Investors actually reward one-timers with a higher initial cumulative abnormal return (CAR) than they give portfolio builders—perhaps because they give the company credit for seizing an attractive “once-in-a-lifetime” opportunity. (CAR assesses a deal’s impact by measuring the total abnormal change in market value over a seven-day window centered on the transaction announcement date.<sup>1</sup>) But inexperienced buyers are likely to underestimate the complexity that comes with an acquisition and the difficulty of integrating two organizations, so they often fail to reap the promised synergies. Initial high hopes are frequently fol-

lowed by low returns. Experienced buyers, by comparison, tend to overcome initial capital market skepticism by executing a sound PMI plan well and delivering improved performance over time. (See Exhibit 17.)

One reason is that frequent acquirers are much more likely to have the necessary commitment, experience, and ongoing incentives to overcome the hurdles inherent in PMI. Most companies address their lack of experience by reallocating resources and building or hiring temporary capability to handle integrations on an ad hoc basis. But building these capabilities can be time consuming and difficult. Those companies whose strategies lead to more frequent acquisitions often choose to build more of this capability on a permanent basis in-house. They have trained people, designed processes and templates, and set up structures, moving beyond the common ad hoc approach. They have consolidated and

## EXHIBIT 16 | Strategic Acquirers Enhance Value for Their Shareholders



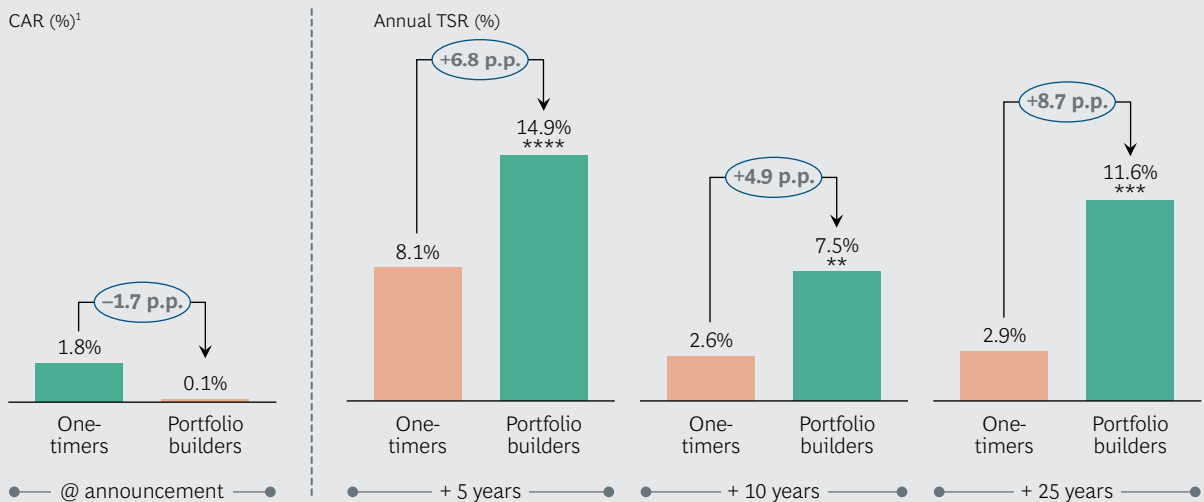
Sources: Thomson Reuters Datastream; Thomson ONE Banker; BCG analysis.

Note: This analysis is based on a sample of 18,928 companies (13,151 acquisitive companies and 5,777 organic growth companies). One-timers made 1 acquisition within the 5-year period, 1 to 2 acquisitions within the 10-year period, and 1 to 5 acquisitions over the 25-year period observed. Active buyers made 2 to 5 acquisitions within the 5-year period, 3 to 10 acquisitions within the 10-year period, and 6 to 25 acquisitions over the 25-year period observed. Portfolio builders made more than 5 acquisitions within the 5-year period, more than 10 acquisitions within the 10-year period, and more than 25 acquisitions over the 25-year period observed. There is a statistically significant TSR difference for portfolio builders and active buyers versus one-timers; \*\* significant at  $p < 0.01$ ; \*\*\* significant at  $p < 0.001$ ; \*\*\*\* significant at  $p < 0.0001$  (using a two-sample t-test).

## EXHIBIT 17 | For One-Time Acquirers, Low Returns Often Follow High Hopes

WHILE INVESTORS REWARD ONE-TIMERS WITH A HIGHER CAR WHEN A DEAL IS ANNOUNCED ...

... PORTFOLIO BUILDERS GENERATE HIGHER RETURNS OVER 5, 10, AND 25 YEARS



**Underestimated PMI complexity is a likely root cause for the failure of inexperienced buyers' long-term performance.**

Sources: Thomson Reuters Datastream; Thomson ONE Banker; Thomson Reuters Worldscope; BCG analysis.

Note: This analysis is based on a sample of 18,928 companies, including 13,151 acquisitive companies. One-timers made 1 acquisition within the 5-year period, 1 to 2 acquisitions within the 10-year period, and 1 to 5 acquisitions over the 25-year period observed. Portfolio builders made more than 5 acquisitions within the 5-year period, more than 10 acquisitions within the 10-year period, and more than 25 acquisitions over the 25-year period observed. There is a statistically significant TSR difference for portfolio builders and active buyers versus one-timers; \*\* significant at  $p < 0.01$ ; \*\*\* significant at  $p < 0.001$ ; \*\*\*\* significant at  $p < 0.0001$  (using a two-sample t-test).

<sup>1</sup>CAR = cumulative abnormal return calculated over a seven-day window centered around the announcement date (+ 3/- 3).



spread the specialized PMI knowledge held by some people to the wider organization.

As is often the case, there is a catch to acquiring one's way to growth. A dollar bought has to work harder than a dollar earned. Since financial markets recognize that many companies do not do acquisitions well, they are skeptical of all deal-doers, even those that have demonstrated substantial proficiency. This should not come as a surprise considering that acquired growth comes often at the expense of diluted margins, and many acquisitions subsequently fail entirely. As a result, investors require acquisitive companies to achieve higher growth rates than their nonacquisitive counterparts in order to reach the same TSR. (See Exhibit 18.)

### Timing Matters . . .

Companies can't control macroeconomic trends and market conditions, but our analysis shows that there are definite circumstances under which acquisitions have a better chance of generating higher shareholder returns than others. (See Exhibit 19.) The ideal circumstance is a combination of low eco-

nomie growth and low market volatility. Research shows that more than half of acquisitions made under these conditions (which are precisely the circumstances in which respondents to our 2014 Investor Survey indicated a high degree of receptivity to M&A) are successful and that they generate an average one-year RTSR of 7.4 percent (better than the relevant industry index). By contrast, almost two-thirds of acquisitions made in times of high growth (which often also means higher inflation) and high volatility fail to generate a positive TSR. Acquisitions that are made under mixed circumstances have slightly less than a 50 percent chance for success.

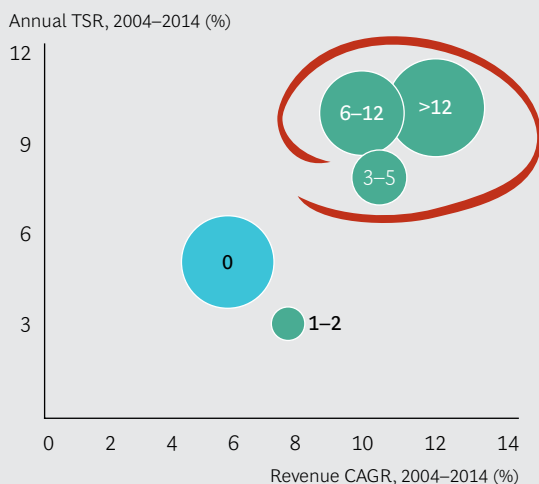
### . . . As Does Communication

Capital markets hate surprises, which is one reason why good managements communicate regularly with their investors. Shareholders are more likely to react favorably to a deal announcement if they have been made aware that such a move is a possibility and the strategic thinking behind it.

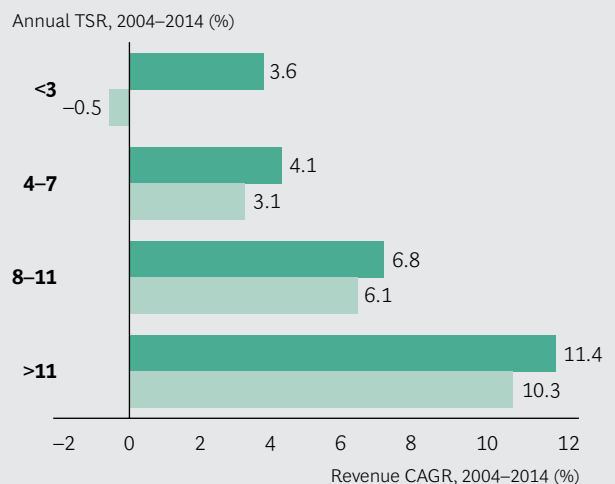
PMI actually begins the moment a deal is announced, when management communicates

## EXHIBIT 18 | A Dollar Bought Is Less Than a Dollar Earned Organically

ACQUISITIVE COMPANIES ACHIEVED HIGHER TSR AND REVENUE GROWTH THAN NONACQUISITIVE COMPANIES



TO REALIZE THE SAME TSR, ACQUISITIVE COMPANIES MUST ACHIEVE HIGHER REVENUE GROWTH THAN NONACQUISITIVE COMPANIES



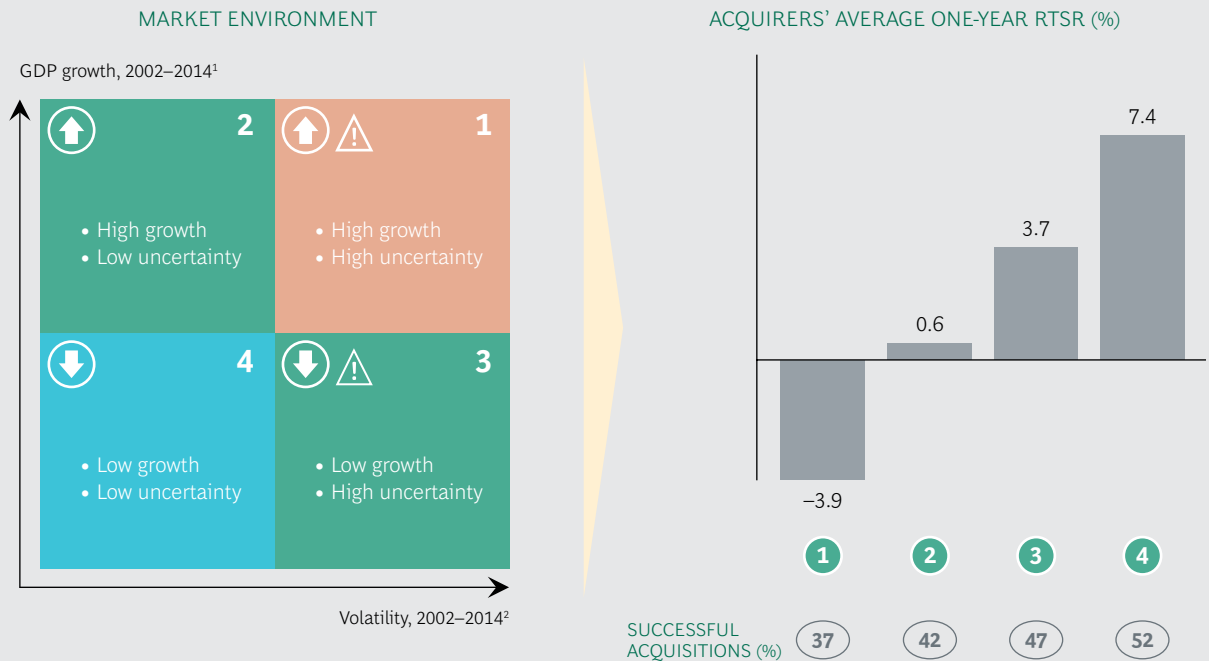
● Number of transactions within observed time period

■ Acquisitive companies ■ Nonacquisitive companies

Sources: Thomson Reuters Datastream; Thomson ONE Banker; BCG analysis.

Note: This analysis, which is based on transactions from 2004 through 2014, excludes companies from the financial services industry. The size of each bubble represents the average number of transactions during that time period.

## EXHIBIT 19 | Market Environment Remains a Key Factor in Acquisition Success



the rationale for the transaction and quantifies the synergies that shareholders can expect. BCG research has shown that shareholders welcome details about the logic underlying a transaction and reward communicative acquirers with higher-than-expected valuations during the period after merger announcements. The valuations of acquirers that quantify synergies as part of merger announcements are roughly 5 percent higher, on average, than those of acquirers that make no such disclosure. Further, the valuation of the combined companies is approximately 6 percent higher than it is for comparable companies that don't disclose synergies. The value-creating potential of such announcements is especially high in transparent markets that are well covered by equity analysts. In such cases, sellers and their shareholders tend to have a clear idea of the potential synergies they are relinquishing by selling. (See *Enabling PMI: Building Capabilities for Effective Integration*, BCG Focus, July 2012.)

All the communication in the world, however, cannot preserve the value of a combined company that fails to deliver against the synergy

expectations it creates. BCG has identified a set of best practices for setting synergy expectations at the time a deal is announced and for tracking progress against synergy targets. Among these best practices are the following:

- Provide a context for the current deal by referring to earlier transactions that demonstrate that each new deal is premised on sound, consistent strategic logic.
- Explain in detail the rationale for the current deal in the form of a narrative that takes into account macroeconomic conditions, industry fundamentals, and the competitive positions and differentiating strengths of both acquirer and target.
- Disclose the (conservative, but yet sufficient) value of anticipated synergies and their sources and provide—and regularly update—a timetable for realizing that value.

As varied as these practices are, they are rooted in a single imperative: be straightforward,

candid, and as accurate as possible. Setting expectations too low risks making the seller's investors feel sandbagged when the company overdelivers against them; but setting them unrealistically high risks harming the company's long-term credibility in the marketplace. Investors will welcome and reward overdelivery against credible expectations, of course, but the long-term cost of unrealistic promises far outweighs whatever short-term gains those promises may produce.

**F**OR plenty of companies, especially those in mature industries or those sitting on big reserves of cash, the temptation to jump into the M&A ring is currently rising. Attractive targets are few, and daily announcements of new deals raise the specter of M&A musical chairs—no company wants to be the one left standing, without its desired merger partner, when the music stops.

But—and this is often a billion-dollar “but”—the data also show that most companies are not prepared to acquire their way to growth. Even if they choose well and negotiate effectively, they don't have the in-house experience or capabilities to integrate the combined operations in such a way that achieves the potential synergies—maximizing top-line growth, bringing that growth to the bottom line, and driving increasing TSR. M&A and PMI must be approached in a systematic, rigorous manner, just like any other management process. Counting on luck is hardly an effective strategy.

This is not to say that companies should forgo acquisitions—far from it. Despite conventional wisdom about destroying value, the data demonstrate that M&A can be a highly effective route to growth and to increasing shareholder returns. But companies other than serial acquirers need to recognize their shortcomings and prepare themselves for a different kind of corporate challenge than the ones they are used to. This advice is not new. Confucius observed around the fifth century BC, “Success depends upon previous preparation, and without such preparation there is sure to be failure.” Or, as the Roman philosopher Seneca put it a few centuries later, “Luck is a matter of preparation meeting opportunity.”

#### NOTE

1. BCG performs standard event-study analysis on each deal in our database to calculate the cumulative abnormal return (CAR) over the seven-day window centered around the date a deal was announced. Short-term returns are not distorted by other events—a material advantage over other M&A metrics—and there is evidence that CAR is, on average, a reliable predictor of long-term success.

# APPENDIX I

## METHODOLOGY

The research that underpins this report was conducted by the BCG Transaction Center during the first half of 2015. The results are based on analyses of more than 40,000 M&A transactions.

In assessing general market trends, we analyzed all reported M&A transactions from 1990 through the beginning of 2015. For the analysis of deal values and volumes, we excluded those marked as repurchases, exchange offers, recapitalizations, and spin-offs.<sup>1</sup>

### Short-Term Value Creation

Although distinct samples were required in order to analyze different issues, all valuation analyses employed the same econometric methodology. For any given company  $i$  and day  $t$ , the abnormal (that is, unexpected) returns ( $AR_{i,t}$ ) were calculated as the deviation of the observed returns ( $R_{i,t}$ ) from the expected returns  $E(R_{i,t})$ . (See Equation 1.)

#### EQUATION 1

$$AR_{i,t} = R_{i,t} - E(R_{i,t})$$

Following the most commonly used approach, we employed a market model estimation to calculate expected returns.<sup>2</sup> (See Equation 2.)

#### EQUATION 2

$$E(R_{i,t}) = \alpha_i + \beta_i R_{m,t} + \varepsilon_{i,t}$$

The derived alpha ( $\alpha_i$ ) and beta ( $\beta_i$ ) factors are then combined with the observed market returns ( $R_{m,t}$ ). (See Equation 3.)

#### EQUATION 3

$$AR_{i,t} = R_{i,t} - (\alpha_i + \beta_i R_{m,t})$$

See the exhibit “Event Study Setup” for a graphic representation.<sup>3</sup> We derive the cumulative abnormal return, or CAR, by aggregating the abnormal returns (that is, the difference between actual stock returns and those predicted by the market model) day by day throughout the event period extending from three days before to three days after the announcement date. (See Equation 4.)

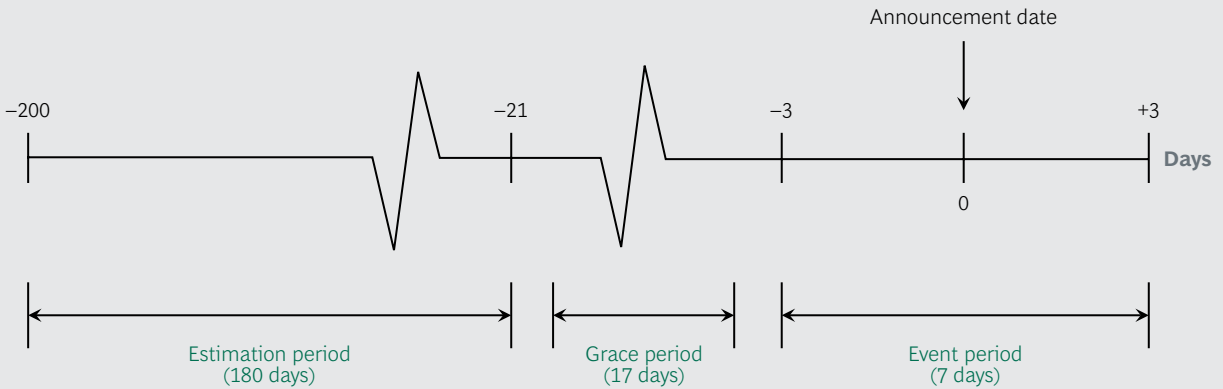
#### EQUATION 4

$$CAR_i = \sum_{t=-3}^{+3} (R_{i,t} - E(R_{i,t}))$$

### Long-Term Value Creation

Our long-term value-creation study uses the data sample applied in the event study analysis as a starting point. We then track the stock

## Event Study Setup



Source: BCG analysis.

market performance of the acquirers over a two-year period following the acquisition announcement. Note that we cannot track the targets owing to their delisting from the public-equity markets in most cases.

First, we measure absolute total shareholder return (ATSR) generated by the acquirer from the starting price ( $P_{start}$ ) over a 365-day (one-year return) period ( $P_{1yr}$ ), as well as over a 730-day (two-year return) holding period ( $P_{2yr}$ ). (See Equation 5.) To avoid short-term distortions, we use the same time periods and averages as for the market performance of the acquirers.

### EQUATION 5

$$P_{start} = \text{average} [ P_{t-60}, P_{t-30} ]$$

$$P_{1yr} = \text{average} [ P_{t+350}, P_{t+380} ]$$

$$P_{2yr} = \text{average} [ P_{t+715}, P_{t+745} ]$$

Second, we subtract from the ATSR the return made by a benchmark index over the same period in order to find the relative total shareholder return (RTSR) generated by the acquirer—in other words, the return in excess of the benchmark return.<sup>4</sup> (See Equation 6.)

### EQUATION 6

$$TSR_{acq.} = P_{1yr, acq.} / P_{start, acq.} - 1$$

$$TSR_{index} = P_{1yr, index} / P_{start, index} - 1$$

$$RTSR_{acq} = ( TSR_{acq} / TSR_{index} ) - 1$$

Note that we cannot include deals undertaken after January 31, 2014, because the time elapsed since the announcement is too short to calculate the one-year relative returns.

### NOTES


1. These transactions do not result in a change in ownership. Exchange offers seek to exchange consideration for equity or securities convertible into equity.
2. See Eugene F. Fama, Lawrence Fisher, Michael C. Jensen, and Richard Roll, "The Adjustment of Stock Prices to New Information," *International Economic Review* 10, February 1969; and Stephen J. Brown and Jerold B. Warner, "Using Daily Stock Returns: The Case of Event Studies," *Journal of Financial Economics* 14, 1985.
3. As proxies for the market portfolio, we apply Thomson Reuters sector indexes, thus controlling for industry idiosyncrasies.
4. The benchmark indexes we apply are the relevant worldwide Thomson Reuters sector indexes.

# APPENDIX II

## SELECTED TRANSACTIONS, 2015, 2014, AND 2013

### Corporate Transactions

**2015**



**VDM Metals**

Strategic advisor to the seller

Not disclosed

BCG  
The Boston Consulting Group

**2014**



**Pharmaceutical Devices and Prescription Retail Packaging**

Strategic advisor to the seller

\$805M

BCG  
The Boston Consulting Group

**2014**



**AFG**  
*Building the Difference*



**AFG**  
*Kitchen Business*

Strategic advisor to the seller

Not disclosed

BCG  
The Boston Consulting Group

**2014**





**FIDELIDADE**  
SEGUROS DESDE 1808

Strategic advisor to the seller

€1,000M

BCG  
The Boston Consulting Group

**2014**

Strategic advisor to the seller

€1,3B

BCG  
The Boston Consulting Group

**2014**



**The co-operative**



**The co-operative pharmacy**  
Part of the Bestway Group

Strategic advisor to the seller

€783M

BCG  
The Boston Consulting Group

**2014**



**AFFIN HOLDINGS**



**HwangDBS**  
COMMERCIAL BANK

Strategic advisor to the buyer

\$411M

BCG  
The Boston Consulting Group

**2014**



**symrise**  
always inspiring more...



**DIANA**  
Performance from nature

Strategic advisor to the buyer

€1,300M

BCG  
The Boston Consulting Group

**2014**



**BRICKMAN**



**ValleyCrest**  
Landscape Companies

Strategic advisor to the buyer

Not disclosed

BCG  
The Boston Consulting Group

**2014**





Strategic advisor to the buyer


€308M

BCG  
The Boston Consulting Group

**2014**



**RAMBOLL**




**ENVIRON**

Strategic advisor to the buyer


Not disclosed

BCG  
The Boston Consulting Group


**2014**



**IMMOBILIEN SCOUT 24**



**HELLMAN & FRIEDMAN**




**FLOWFACT**  
Relations. Apps.

Strategic advisor to the buyer

Not disclosed

BCG  
The Boston Consulting Group

**2013**




**DELL**

Strategic advisor to the seller


\$24,400M

BCG  
The Boston Consulting Group

**2013**



**TOTAL**




**TIGF**

Strategic advisor to the seller


€2,400M

BCG  
The Boston Consulting Group

**2013**



**gsk**



**Ribena**  
*Lucozade*

Strategic advisor to the seller

€1,600M

BCG  
The Boston Consulting Group

Private-Equity Transactions

2015

**Apax**  
PARTNERS

**azelis**

Strategic advisor to the buyer

Not disclosed

BCG  
The Boston Consulting Group

2015

**VITRUVIAN**  
PARTNERS

**C-R-F**  
HEALTH  
REAL PATIENT DATA 24/7

Commercial due diligence provider

Not disclosed

BCG  
The Boston Consulting Group

2015

veritas 

Shareholders

**veritas** 

Strategic advisor to the seller

Not disclosed

BCG  
The Boston Consulting Group

2014

**APOLLO**

**PRESIDIO**

Strategic advisor to the buyer

Not disclosed

BCG  
The Boston Consulting Group

2014

**BC Partners**

**PETSMART**

Strategic advisor to the buyer

\$8,700M

BCG  
The Boston Consulting Group

2014

**NORDIC CAPITAL**

**GHD** *gesundheits GmbH Deutschland*

Strategic advisor to the buyer

\$500M

BCG  
The Boston Consulting Group

2014

**CLESSIDRA**  
*Capital Partners*

**Harmont & Blaine**  
*(Minority stake)*

Strategic advisor to the buyer

Not disclosed

BCG  
The Boston Consulting Group

2014

**CapMan**

**HARVIA**

Strategic advisor to the buyer

\$124M

BCG  
The Boston Consulting Group

2014

**PORSCHE SE**

**INRIX**

Strategic advisor to the investor

\$55M

BCG  
The Boston Consulting Group

2014

**Goldman Sachs**

**MISTER SPEX**

Strategic advisor to the investor

\$40M

BCG  
The Boston Consulting Group

2014

**ASTORQ**  
private equity

**Montagu**

**sebia**

Strategic advisor to the buyer

€1,400M

BCG  
The Boston Consulting Group

2014

**PAMPLONA**  
CAPITAL MANAGEMENT

**OCTO**  
*The reliable way*

*(Minority stake)*

Strategic advisor to the buyer

Not disclosed

BCG  
The Boston Consulting Group

2014

**Montagu**  
private equity

**open gi**

Strategic advisor to the buyer

Not disclosed

BCG  
The Boston Consulting Group

2014

**EQT**  
**BSN** *medical*

**sorbion**  
*health needs care*

Strategic advisor to the buyer

Not disclosed

BCG  
The Boston Consulting Group

2014

**CPP INVESTMENT BOARD**

**Interparking**  
*(Minority stake)*

Strategic advisor to the buyer

€376M

BCG  
The Boston Consulting Group

2014

**EMERAM**  
CAPITAL PARTNERS

**Bench.**

Strategic advisor to the buyer

Not disclosed

BCG  
The Boston Consulting Group

2014

**THL** Thomas H. Lee Partners

**PHILLIPS**  
PET FOOD & SUPPLIES  
Since 1930

Strategic advisor to the buyer

Not disclosed

BCG  
The Boston Consulting Group

2014

**方源資本**  
FOUNTAINVEST PARTNERS

**KHB**

Strategic advisor to the buyer

\$264M

BCG  
The Boston Consulting Group

2014

**sentica**partners

**secto**leasing

Strategic advisor to the buyer

Not disclosed

BCG  
The Boston Consulting Group

2014

**CapMan**

**KAMP**  
GROUP

Strategic advisor to the buyer

Not disclosed

BCG  
The Boston Consulting Group

2014

**Audax**  
Group

**AP**  
EXHAUST TECHNOLOGIES®

Strategic advisor to the buyer

Not disclosed

BCG  
The Boston Consulting Group

2014

**PAROC**  
Lenders & Employees

**PAROC**

Strategic advisor to the seller

\$700M

BCG  
The Boston Consulting Group

2014

**BC Partners**

**spotless**  
Group

Strategic advisor to the seller

€940M

BCG  
The Boston Consulting Group

2014

**ALTOR**  
EQUITY PARTNERS

**SONION**

Strategic advisor to the seller

Not disclosed

BCG  
The Boston Consulting Group

2014

**RANK GROUP LIMITED**

**SIG**

Strategic advisor to the seller

€3,750M

BCG  
The Boston Consulting Group

**Private-Equity Transactions**  
(continued)

<p><b>2014</b></p>   <p>Strategic advisor to the seller</p> <p>Not disclosed</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2014</b></p>   <p>Strategic advisor to the seller</p> <p>€800M</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2014</b></p>   <p>Strategic advisor to the seller</p> <p>\$1,600M</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2014</b></p>   <p>Strategic advisor to the seller</p> <p>Not disclosed</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2014</b></p>   <p>Strategic advisor to the seller</p> <p>Not disclosed</p> <p>BCG <small>The Boston Consulting Group</small></p>
<p><b>2014</b></p>   <p>Strategic advisor to the buyer</p> <p>Not disclosed</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2014</b></p>   <p>Strategic advisor to the buyer</p> <p>Not disclosed</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2014</b></p>    <p>Strategic advisor to the buyer</p> <p>Not disclosed</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2013</b></p>   <p>Strategic advisor to the buyer</p> <p>€585M</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2013</b></p>   <p>Strategic advisor to the seller</p> <p>€1,350M</p> <p>BCG <small>The Boston Consulting Group</small></p>
<p><b>2013</b></p>   <p>Strategic advisor to the buyer</p> <p>Not disclosed</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2013</b></p>   <p>Strategic advisor to the seller</p> <p>€509M</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2013</b></p>   <p>Strategic advisor to the buyer</p> <p>Not disclosed</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2013</b></p>   <p>Strategic advisor to the seller</p> <p>\$715M</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2013</b></p>   <p>Strategic advisor to the buyer</p> <p>Not disclosed</p> <p>BCG <small>The Boston Consulting Group</small></p>
<p><b>2013</b></p>   <p>Strategic advisor to the buyer</p> <p>€200M</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2013</b></p>   <p>Strategic advisor to the buyer</p> <p>\$100M</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2013</b></p>   <p>Strategic advisor to the buyer</p> <p>€15M</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2013</b></p>   <p>Strategic advisor to the seller</p> <p>Not disclosed</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2013</b></p>   <p>Strategic advisor to the buyer</p> <p>Not disclosed</p> <p>BCG <small>The Boston Consulting Group</small></p>
<p><b>2013</b></p>   <p>Strategic advisor to the buyer</p> <p>€36M</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2013</b></p>   <p>Strategic advisor for setting up JV</p> <p>\$500M</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2013</b></p>   <p>Strategic advisor to the buyer</p> <p>Not disclosed</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2013</b></p>   <p>Strategic advisor to the seller</p> <p>\$124M</p> <p>BCG <small>The Boston Consulting Group</small></p>	<p><b>2013</b></p>   <p>Strategic advisor to the buyer</p> <p>\$126M</p> <p>BCG <small>The Boston Consulting Group</small></p>



# FOR FURTHER READING

The Boston Consulting Group publishes many reports and articles on corporate development and finance, M&A, and PMI that may be of interest to senior executives. The following are some recent examples.

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The 2015 Value Creators Report, July 2015

## **M&A in China: Getting Deals Done, Making them Work**

A Focus by The Boston Consulting Group, January 2015

## **Unlocking Acquisitive Growth: Lessons from Successful Serial Acquirers**

BCG Perspectives, October 2014

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## **Don't Miss the Exit: Creating Shareholder Value Through Divestitures**

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## **Taking a Portfolio Approach to Growth Investments**

BCG Perspectives, July 2014

## **Growth for the Rest of Us**

BCG Perspectives, January 2014

## **Divide and Conquer: How Successful M&A Deals Split the Synergies**

A Focus by The Boston Consulting Group and Technische Universität München, March 2013

## **Enabling PMI: Building Capabilities for Effective Integration**

A Focus by The Boston Consulting Group, July 2012

# NOTE TO THE READER

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## For Further Contact

This report is a product of BCG's Corporate Development practice, which works with its clients to deliver solutions to the challenges addressed in this report. If you would like to discuss the insights drawn from this report or learn more about the firm's capabilities in M&A, please contact one of the authors.

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