

„Who dares Wins!“

Leveraging downturns to make acquisitions

During economic downturns, most companies face severely challenging times and therefore adopt defensive strategies, focusing their energy on restructuring and cash management aspects. On the other hand, these periods are a unique opportunity to undertake offensive strategies and create competitive edge. Specifically, our analysis shows that, on average, acquisitions during cycle troughs create value and are a means of outperforming competitors. However, execution is key and requires both anticipation and agility.

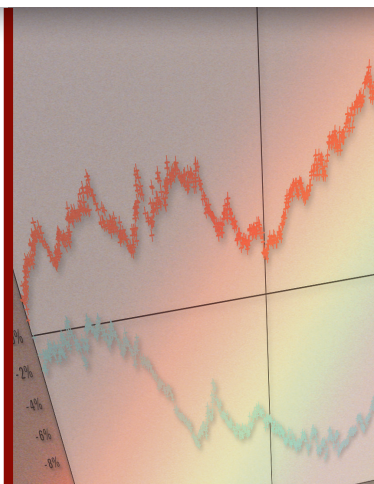
Business downturns, especially of the type we experienced in 2008-2009, represent a kind of „survival test” for many companies. Executives are reluctant to talk about M&As in such tough times and frequently seek good reasons for postponing possible acquisitions.

When facing major turbulence, companies focus mainly on their clients, manage cash carefully and take restructuring action to adapt their cost structures. An assessment of European M&A activity over business cycles in terms of deal values appears to support this point (see fig. 1). However, when one considers the number of deals, it would appear that M&A activity remains relatively steady during downturns.

Moreover, if we make a distinction between private equity deals and corporate deals, we see that during the 2008-2009 crisis private equity activity collapsed (linked to the lack of available debt), while corporate deals remained on a level slightly above 2007.

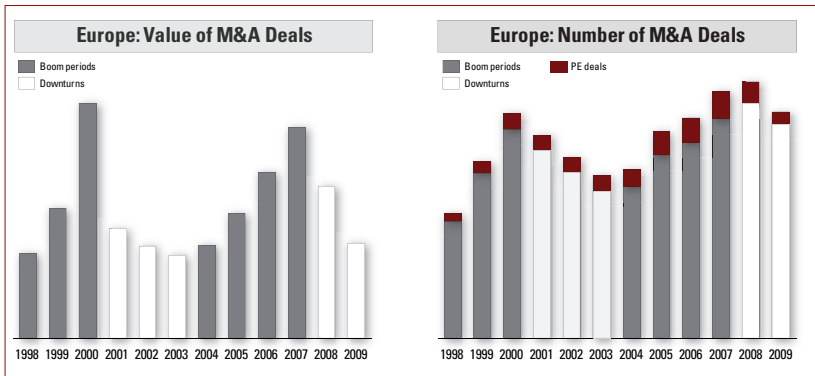
In view of this somewhat counter-intuitive fact, we can easily imagine that certain predators have been exploiting the downturn in order to fall upon weakened prey. However, before attempting to adopt such a strategy, two key questions need to be answered:

- Is such a strategy relevant in terms of value creation?
 - What are the golden rules for success?
- It is generally recognized that acquisitions rarely create as much value as initially expected. In order to clearly assess the respective value creation of deals in downturns and boom periods, we have adopted the following methodology:
- We looked at the 50 biggest European corporate acquisitions per year over the 1998-2009 period.
 - We selected „pure-cycle players”: companies that have carried out more than 80% of their total deal value during downturns or boom periods.
 - We studied their share price evolution compared to their peers (same busi-



Acquisitions during cycle troughs create value and are a means of outperforming competitors.

FIGURE 1: Despite deals value strongly drop during cycle trough, number of corporate deals keeps steady



Source: A.T. Kearney

ness sector), from 2 days before the acquisition to 2 years after the acquisition.

- We gave all companies the same weighting and compared the average share price evolution between the 2 groups.

By comparing companies with their peers via the industry index we made sure that we ended up comparing „apples with apples“ and that the metrics are not falsified by overall stock market price cycles. The results of the analysis led to several key findings (see fig. 2):

First of all, the share price evolution of companies undertaking acquisitions during downturns is more favorable than the share price evolution of companies undertaking acquisitions during boom periods. This outperformance remains true within at least the next two years after the deal and seems sustainable, with a gap in stock value of around 15-20% between the two groups.

Given that the „zero“ line represents the industry index, we can conclude that companies which make acquisitions during downturns not only outperform

those which make acquisitions during boom phases but also the industry average (i.e. including companies which made no acquisitions or companies which made acquisitions but couldn't be identified as „pure cycle players“).

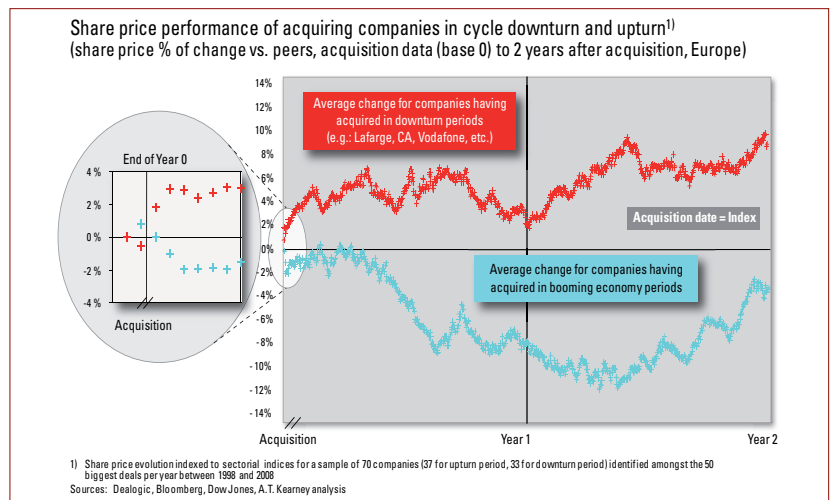
Making acquisitions: a risky strategic move

Of course, this does not mean that making acquisitions during a downturn is sufficient in itself to make a company

successful and create competitive edge. All this remains true on average, but one still has underperforming companies in the „pure downturn players“ group. A more detailed analysis of historical European acquisitions shows the following (see fig. 3):

- The percentage of companies making an acquisition and outperforming their peers is significantly higher during downturn phases (55% versus 34%).
 - The companies outperforming their peers have an average stock price over 2 years about 20% above their peers. This level of outperformance is comparable between successful „pure downturn“ and „pure boom“ companies (19% versus 18%).
 - The companies underperforming their peers have very different stock price performances, depending on whether they are „pure downturn“ (-10%) or „pure boom“ (-19%) players.
- Ultimately, making acquisitions remains

FIGURE 2: Acquisitions in downturns lead to more value creation than in boom periods



Source: A.T. Kearney

a risky strategic move statistically (only 55% over-performers even in the „pure downturn” segment). However, making acquisitions during boom periods appears to be a dangerous undertaking: 66% of players underperformed their peers with an average underperformance on stock price of around -20% compared with their peers.

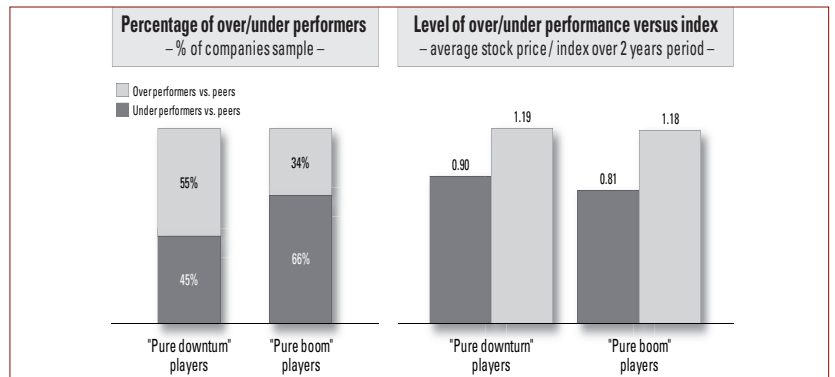
As we have just seen, making acquisitions during a downturn is not a guarantee of success in itself, with about 45% of companies underperforming their peers. In addition to the statistical analysis and the key messages which can be extracted from it, we have discussed these matters with top managers in order to understand more clearly the reasons for making acquisitions in a downturn (we have seen that there are many good reasons not to do so) and the conditions for success.

Making acquisitions during downturns: a favorable environment

Downturns create a favorable environment for acquisitions from several reasons. In particular we can mention the following ones:

Opportunities can arise that would not occur in boom periods. We are not so much talking about transaction prices: even if target stock price is lower in downturns, it is often the case for the acquirer as well and we were unable to demonstrate a significant drop in transaction prices in terms of EBIT or EBITDA multiple. It is more a question of the willingness of the targeted shareholders to accept such a deal: for

FIGURE 3: Outperforming by making acquisitions during downturn phases



Source: A. T. Kearney

example, consolidation moves are difficult to undertake when business is going well and all players are more or less in good shape. In downturn phases, players which were previously reluctant to being taken over realize that it is likely to be the only solution which will strengthen their competitive position and allow them to remain among the leaders in the business or industry.

For example, in the late 1990s Pernod-Ricard had succeeded in establishing a global presence by means of small, but numerous, acquisitions of local players. However, its sales remained focused on the European market, which represented more than 80% of turnover. Even though the acquisitions of local brands had complemented the product portfolio, the potential for these local networks to become global giants remained to be leveraged. Pernod-Ricard faced this challenge with the benefit of a positive track record of acquisitions. It kick-started the run for consolidation among the beverages powerhouses and bought scale, with the assimilation in late 2001 of the beverages industry stalwart Seagram, prob-

ably taking advantage of the state of crisis in which Seagram brands found themselves – especially Chivas and Martell – as well as the failure of Allied Domecq to submit a bid. Clearly shaken by the crisis in the early 2000s and unable to join the race for major acquisitions, the latter would finally fall to Pernod-Ricard in 2005. Vin & Spirit was subsequently purchased from the Swedish State on the cusp of the 2008 credit crunch, along with its strong presence in the US market and its famous Absolute Vodka brand. It thus appears that the 21st century downturns have given Pernod-Ricard the opportunity to conclude the three biggest and possibly most far-reaching deals in its history: today, Pernod-Ricard sales outside the European market account for more than half of its turnover.

Many mergers or acquisitions fail to create the expected synergies due to execution issues. During boom phases in particular it is difficult to carry out restructuring programs for many different reasons (social and political issues, impact on company or brand image,

etc.). In downturns, the sense of urgency is clearly shared among stakeholders (shareholders, managers, employees and even customers) and therefore the implementation of synergies is made easier, increasing the likelihood of outperforming one's peers. This is especially true in the case of capacity-driven businesses requiring consolidation and supply/demand balance.

Dare and Win

Successful players we have talked to have helped us to formulate several key success factors for making acquisitions during downturns.

First of all, once the downturn is there, it is already too late to wake up in the morning looking for potential targets. All the successful players told us that the acquisition they made during the downturn was on a list of targets that had already been studied and analyzed (and even unsuccessfully approached, in several cases) in detail for months or even years. The strategic reasoning was clear, the synergies were identified, the required resources were qualified and quantified, and communications were prepared: almost everything was ready for execution once the red button was pushed. The winners have basically a set of potential targets and al-

ternative options that they manage in the long run, the downturn being then a „make it happen” opportunity, as mentioned earlier.

Secondly, a perfect alignment among top management and between top management and shareholders is required. The window of opportunity is small and there is no time for additional doubt, analysis or discussions. Reactivity is the key and top management need to be skilled „multitaskers“ in order to manage complex everyday business in a crisis situation while dedicating time and resources to concluding a deal within a short space of time.

Last but not least, controlling the timing and daring to make the acquisition are the most critical factors, especially when downturns are extremely severe as in 2008-2009. It is difficult to make such a strategic move when the business environment is unstable and uncertainty at its greatest. However, historical analysis shows that waiting for stabilization means more or less missing the window of opportunity. One major player in the automotive industry which made a major acquisition in 2009 told us the following story. When all the above mentioned conditions were fulfilled and everything ready for the acquisition, one member of the board

made the following comment: „For sure, the situation is unstable and we don't know what will happen tomorrow. We have been looking out for such a deal for years. We are all convinced it makes sense for our company and the window of opportunity is extremely small. I know that our business volumes have dropped by 35% and our stock price by 50% ... it might seem more reasonable to wait in case volumes drop by a further 20% ... but in this case I'm afraid that the question would not be knowing whether making an acquisition now was right or wrong – the question would be for all of us and our employees to find a new job in another industry!”

Finally they dared, hopefully the near future will show if they won...

Making one step back, we have seen that despite prevalent reluctance to go for acquisitions during economic trough, some players leverage the favorable conditions to close deals, sometimes enjoying unique opportunities. In average, those who dare to acquire in downturns create more value than those who make acquisitions during boom phases and even than the average industry. However, the window of opportunity is narrow and anticipation, strategic rationale and flawless execution are the centerpieces for success.

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