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Winning in M&A: Best practices from leading consumer companies

Consumer companies, struggling with growth, are looking to M&A to address their ambitions. However, doing deals is not enough, as current market multiples present challenges to value creation. New KPMG research reveals three key tactics for realizing the full value from deal activity.

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In the last decade, we have seen organic growth at many of the large consumer companies slow. In an effort to continue to create the high levels of return that shareholders have come to expect from this sector, many executive teams have undergone aggressive cost cutting plans and have been turning to M&A to achieve their financial and strategic ambitions. However, in today's aggressive capital market environment, companies often question whether they can achieve accretive deal value given the high valuations that strategic assets can command. This has become an even more critical question since much of the low hanging fruit in traditional cost take-out programs have run their course. KPMG research reveals that acquisitions can increase shareholder value despite high valuations and that three key tactics can improve the likelihood of success. In addition, KPMG has identified five successful principles to help companies to get started on the value creation journey.

The challenge: M&A in a high valuation environment

When meeting with CEOs, CFOs, and corporate development teams, one theme they consistently want to discuss is our perspective on the longevity of the high multiples being paid for consumer companies. Our view is that not only will this high multiple environment continue, but that it will increase in the near term. Both corporate and financial buyers have been pursuing a more aggressive M&A agenda in the sector, making deals increasingly competitive. In addition, smaller consumer companies have proliferated on the heels of innovative products and multiple low-cost routes to market, and have had great success when scaled. At the same time, sales of larger, more established companies are dwindling, resulting in significant interest when a sales process begins. Figure 1 shows that the average multiple for companies in the consumer segment has increased from 9x-10x enterprise value/EBITDA in 2009 to 14x-16x in 2017[1].

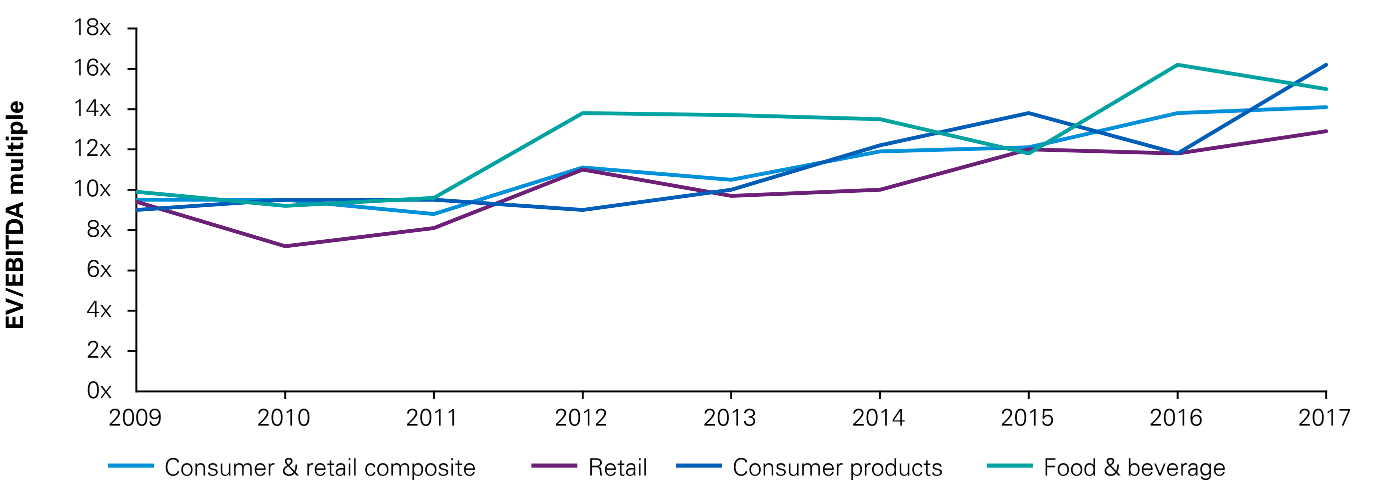
Given these trends, executives are pursuing acquisitions to supplement their continued focus on costs and organic growth agendas and want to know:

- Is it possible to create accretive value with such high valuations?
- If so, what are the leading practices of successful consumer deal-makers that enable them to realize the full value of their acquisition?

In order to answer these questions using historical data, we examined Total Shareholder Return (TSR) as a measure of value creation to determine if and how consumer companies can succeed in this challenging M&A market.

> **"It's hard to convince the Board to pay that much for an asset today, even a good one,"** according to the CFO of a major home products company.

Figure 1: Consumer & retail EV/EBITDA multiples paid analysis – 2009 to 2017[1]



Note: Includes completed US transactions with greater than $100m in value

[1]Source: Thomson Reuters.

The best companies do create value, despite high multiples

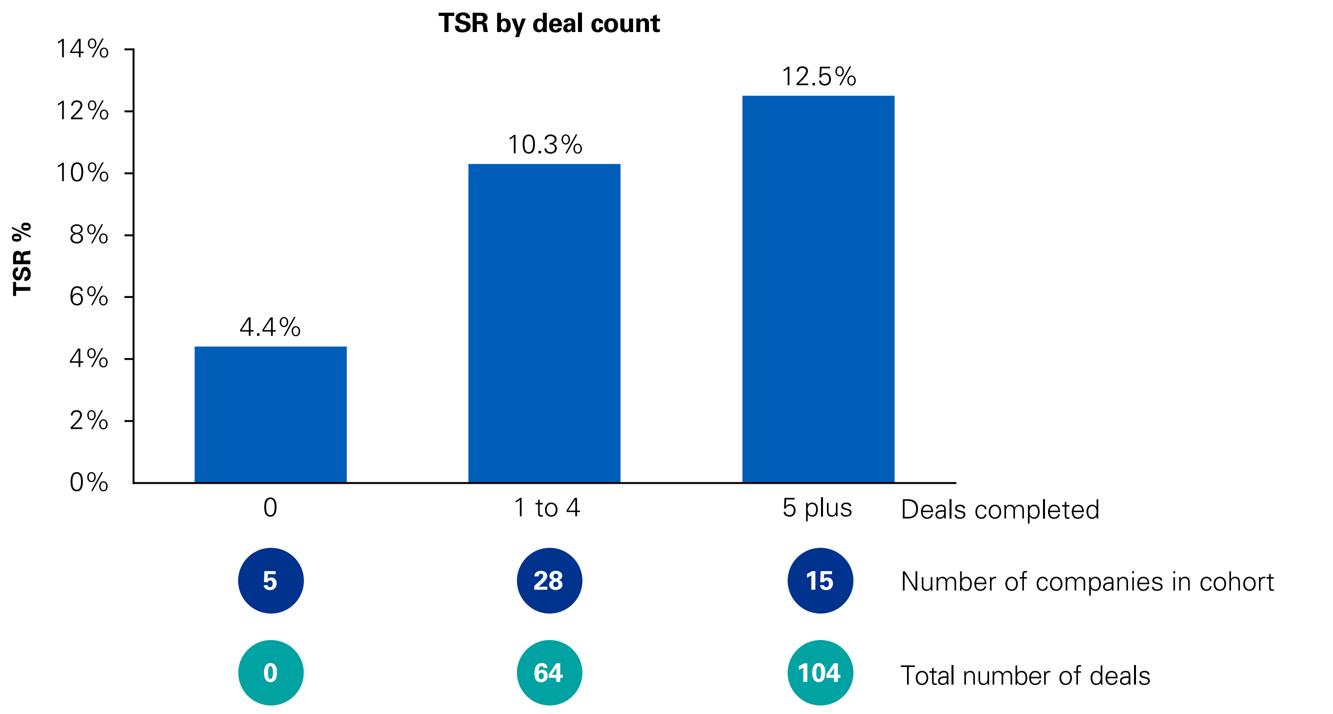
KPMG looked at the top 50 publicly traded consumer companies and the 168 M&A transactions they completed over a five-year period, from 2013 to 2017. We then compared each of the 50 companies' TSR over the two-year period following each acquisition to determine which deals resulted in a higher average TSR and what the best companies did to ensure the full potential of each deal.

Figure 2 shows the results of our initial analysis. Of the total 50 consumer companies evaluated, five did not complete an acquisition over the research period, 28 completed between one and four acquisitions and 15 companies completed five or more transactions. The average TSR for the five companies that did not complete a transaction over the five-year period was 4.4 percent.

However, the average TSR for the 28 companies that completed one to four deals was 10.3 percent or 2.3x the TSR of companies who did not complete transactions. The value rises to 12.5 percent for companies who complete five or more transactions[2]. Put in simpler terms, companies who completed the most transactions were also the ones who delivered the most value to shareholders.

There is also a significant variance in the amount of TSR delivered by companies in each category. While many factors contribute to increased shareholder return, we focused on determining what types of actions the "top performing" acquirers were taking and how strongly those actions correlated to higher value creation. (A detailed methodology is included on page 4.)

Figure 2: Acquisitive companies had higher Total Shareholder Return[2]



Note: Of the 50 companies analyzed, two went private within this time period and were excluded

[2]Source: S&P Capital IQ

How to win: three tactics to maximize value creation in M&A

We examined company SEC filings, analyst reports, press releases, earnings calls and annual reports to determine what separated the best companies from the rest of the pack. KPMG found that companies in the top quartile of performance (i.e., those that had the highest quartile of TSR) adhered to three key tactics. These include:

— Announcing synergy expectations at close

— Publicly tracking synergy progress

— Capturing synergies within the first year.

Our research is summarized in figure 3 and reveals that the leading companies engage in at least one of three important actions and the most successful do all three.

At face value, these three tactics appear to be straightforward and common M&A practices. But, our analysis suggests they are not common at all. Only 50 percent of the companies evaluated engaged in at least one of these practices and less than 20 percent engaged in all three.

Self-assessment: how many of these tactics does your company regularly execute on in every deal?

Figure 3: Attributes of top performing consumer company acquirers

Tactic employed during the transaction	Correlation to higher TSR performance
Announced details of their synergy expectations and plans near transaction close	✓
Publicly tracked and reported their synergy progress post-acquisition	✓✓
Captured a significant portion of synergies quickly, usually within the first year	✓✓✓✓✓
Employed all three tactics during the transaction	✓✓✓✓✓✓

~50% *of companies—the low performers—did **not** use any of these tactics*

<20% *of companies—the highest performers—**did** all three*

Note: Check marks correspond to percentage increase in TSR performance

Methodology

1. Compiled acquisitions announced in relevant time period from Capital IQ's Top 50 Consumer Goods & Retail (CGR) index companies
2. Evaluated two year excess TSR post-deal for all selected deals. Excess TSR is defined as the Company TSR after deal, minus Top 50 CGR index average TSR
3. A subset of top and bottom quartile deals were shortlisted for in-depth analysis
4. For this subset of deals, we determined the existence of the following: whether (1) synergy estimates were announced publicly; (2) synergy progress reports were provided by management; (3) evidence that early wins were captured (e.g., integration completed ahead of schedule with first-year synergy targets met or exceeded)
   a. Sources used included earnings transcripts, analyst reports, SEC filings, etc.
   b. A simple binary flag (Y/N) was used to record if the deal delivered on three characteristics outlined earlier
5. Multiple linear regression was used to quantify the impact of the three characteristics to the two year average excess TSR.

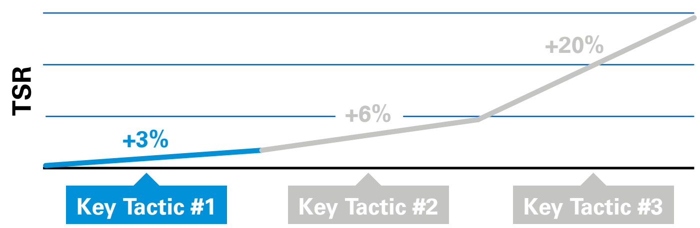
Key Tactic #1

Announce details of synergy expectations and plans before the transaction close

Consumer companies who publicly stated the types of synergies expected (both revenue and cost), detailed the value of those synergies, and had a road map with the expected time frame for realizing those synergies, saw an average increase of shareholder return of approximately three percent higher than their peers.

The announcement indicates that the buyer has conducted a thorough due diligence and has a detailed understanding of how the synergies could be realized. By articulating the expected financial results as well as the time frame, the company gives sufficient information for investors to reach a reasonable conclusion about the merger. That in turn stabilizes the stock price during the early days of the integration. For the buyer, it also lays the groundwork for a detailed synergy delivery plan once the transaction has closed, which saves time and effort once the busy post-close period begins.

Real life example: Of the 168 transactions evaluated, one food company deal was one of the highest performing deals that we analyzed per the TSR methodology. During the course of the transaction, the acquirer disclosed the total synergies attributed to the deal ($255 million in synergies in the first year and $500 million in the second year) as well as how the synergies would be attained.



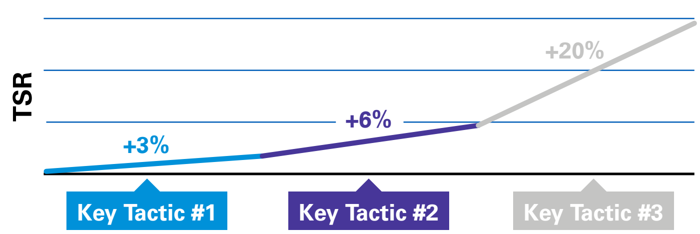
Key Tactic #2

Publicly track and report synergy progress post acquisition

Companies that not only had a willingness to evaluate the deal's progress, but also publicly reveal the results had an average increase of shareholder return of approximately 6 percent more than their peers.

In general, companies that have processes in place to understand and report on key synergy milestones in real time provide investors with the information they need to understand the deal value. This keeps the stock price stable. Additionally, the added discipline of "reporting to the street" helps executives regularly assess what is working in their synergy plan and identify potential gaps sooner than they might have otherwise.

Real life example: When a leading food company acquired a leading beverage company, they viewed the acquisition as more of a growth play, but also expected $50 million in synergies. Many investors, including debt holders, were not initially convinced of the value of the transaction. But the acquirer regularly reported to investors (on a quarterly basis) how the integration was progressing and whether the synergy capture was in line with the plan.



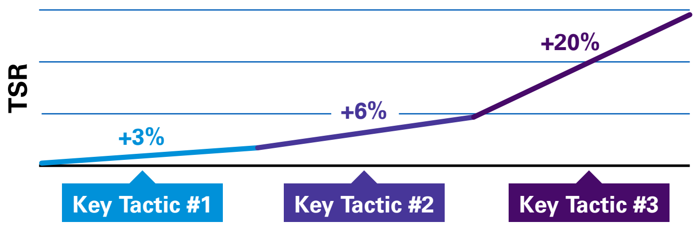
Key Tactic #3

Capture a significant portion of synergies quickly, usually within the first year

The strongest indicator of shareholder value return is actually demonstrating results quickly. Companies that do this have an average increase of shareholder return of approximately 20 percent more than their peers.

The ability to achieve early wins demonstrates that the company has a clear understanding of the deal's value proposition and has put the right teams in place to quickly capture synergies. Doing so gives the market confidence that other, more complex integration goals will also see anticipated results. In addition to increasing shareholder confidence, achieving early wins provides the merged company and its employees with the momentum needed to tackle the next steps in the integration process.

Real life example: A key component of the investment thesis for one leading food company's acquisition of a smaller health focused food company was SG&A spend reduction. Prior to the deal, the target spent ~$1 billion on SG&A, with the acquirer targeting to reduce spend by ~20%. By executing quick wins within SG&A, the acquirer was able to initiate synergy realization just two months after close of the transaction. Their first critical key wins were closing of facilities, consolidating the sales force and implementing spend discipline.



Applying just one of the aforementioned tactics will create above average shareholder value, but best in breed acquirers should do all three. In our study, companies that adhered to all three tactics average increase of shareholder return approximately 30 percent above their peers.

Key principles to optimize synergy results

Like many companies, the initial client synergy estimate shown in the accompanying case study was conservative and there was concern around the ability of the team to deliver. During the course of the engagement, we worked with management to adopt leading practices from other transactions. We used the following leading practices to improve their synergy ambitions and results.

Move fast

Identifying the easy opportunities to accelerate savings is important to put wins on the board and build momentum. However, another benefit from forcing teams to deliver quickly is that it makes them take operational control of the new asset rapidly, which provides a deeper understanding of how to unlock synergies. Too often we hear executives wanting to "let things settle" before the synergies are delivered. However, by the time they do so, the opportunity may be lost. Consumer companies that move too slowly can find themselves distracted by business-as-usual activities. They may also lose synergy opportunities, especially related to people costs, as teams become part of the "corporate family."

Be ambitious

Most executives will underestimate synergy opportunities and don't push teams past their normal comfort zones. More synergies require more risks and there is often a tendency to be overly conservative. But companies that identify risks early on and develop appropriate contingency plans are able to overdeliver and exceed initial expectations. Cross-functional efforts have the most risk and are complicated to deliver, often requiring dedicated teams that spend a significant amount of time on delivery and can't perform this work on top of their regular tasks.

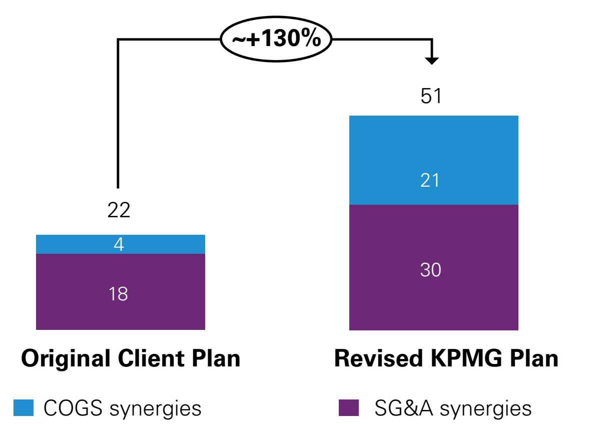
KPMG Case Study

Aggressive value delivery program at a large CPG purchasing a non core strategic asset

Our client was a food company contemplating the acquisition of another food company in an adjacent segment with sales of ~$500 million. The target was owned by a global consumer company and would require a complex carve out. The auction process was very competitive, but our client believed it had certain strengths it could utilize to increase their bid. However there was some reluctance given the target was in a product segment outside of their core business.

KPMG was hired to help maximize synergy identification and ensure delivery in order to justify the high sales price. Over the course of the engagement, KPMG worked closely with senior leadership, the corporate development team and functional/business unit leaders to identify, manage, track and report on synergies before and after the transaction closed. Figure 4 shows the results the program.

Figure 4: Three-year synergy plan comparison ($m)



Source: KPMG analysis

Use data and analytics

Use advanced analytics to reveal key insights into business performance drivers. Rapidly validate key deal model assumptions and the deal thesis with bottom up analysis instead of top down targets. Find incremental value creation opportunities by finding insight in the most granular data.

Develop robust governance

Transform the pre-deal synergy estimates into detailed work plans with dynamic tracking capabilities that are regularly reviewed by a senior team. Integrations are complex and executives get distracted when other aspects of the integration come up and have to be dealt with in real-time. Clarity on responsibilities with regular review will help keep delivery on track.

Measure results

Continuously tracking KPIs to measure success and identify roadblocks is critical as is comparing actual cost savings to the original baselines. Allow executives to have transparency into all synergy areas and provide updates on what is falling behind and why so that difficult decisions can be made sooner. This is often best accomplished by linking the synergy program to budgets with explicit synergy program line items. Nominate a finance lead who understands the synergies and can track progress against expectations. These results can be reported publicly with confidence.

Conclusion

Consumer companies need to ensure that they are realizing optimal deal value and that their synergy expectations are well developed and supported by meaningful data. The best M&A programs take several actions that communicate that a detailed and sufficient due diligence has been performed to confidently project synergy expectations. These actions include publicly announcing their synergy expectations, publicly tracking deal success, and the ability to achieve early wins. Companies who focus on these synergy objectives are rewarded with above-average shareholder returns.

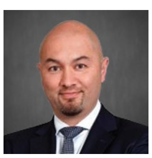
How KPMG can help

KPMG has substantial experience in helping companies both evaluate synergies in a pre-deal setting as well as capture deal value post-close for both strategic and private equity investors. In our experience, the ability and willingness to execute all three of the tactics outlined in this study is often attributed to the confidence the team has in its ability to deliver an aggressive synergy plan. As one FORTUNE 500 CFO told us, "we typically only see about 40 percent of the synergies we expect from a deal." Given today's high deal valuations, companies can neither afford to be conservative about synergy estimates or have low confidence in their ability to achieve above-average results.

In a pre-deal setting, our team will rapidly assess the "total size of the prize," leveraging our significant investments in advanced data and analytics that have been tailored to the deal environment. We develop a robust evaluation of the financial and organizational baselines of the combined entity and then prepare bottom-up estimates of synergy initiatives. These estimates are compared to our database of similar transactions to refine estimates and give companies confidence in announcing aggressive synergy targets.

In the post-close setting, KPMG can help acquirers establish aggressive internal synergy targets and work with functional teams to uncover additional opportunities. We build detailed work-plans for each synergy initiative, assigning functional level accountability with specific milestones and time lines. Our team helps you set up the right tracking and governance programs that capture early wins to gain momentum, boost morale and signal to investors that your synergy plan is on track. This allows you to report regularly on progress with confidence and demonstrate clear achievement in the first year.

Authors



David Roszmann

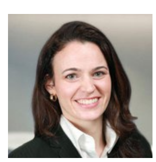
David has 20+ years of experience advising consumer and retail clients on strategy development and operational improvement. In particular, he has deep experience in developing and implementing corporate growth strategy, international expansion, brand development, trade spend optimization, supply chain transformation and development of end-to-end sustainability programs. In addition, David spent three years as a chief operating officer at a U.S. nationally branded consumer packaged goods company with global operations.

Kevin Martin

Kevin has advised domestic and global private equity firms and corporate clients on more than 200 buy-side and sell-side transactions over his nearly 20 year consulting career. He focuses on the consumer and retail sector and has extensive experience managing complex, transformational transactions including numerous cross-border deals. Kevin's background also includes corporate strategy and public company auditing and financial reporting.

Saurabh Gupta

Saurabh focuses on M&A advisory services including due diligence as well as postacquisition value creation opportunities. He has over 12 years of experience advising FORTUNE 500 companies and private equity clients on a broad range of issues, including M&A strategy, postmerger integration, commercial and operational due diligence, business plan development, corporate long range planning and operational effectiveness.



Julia Wilson

Julia Wilson has 14 years of experience across the retail and consumer goods industries including fast-moving consumer goods, retail, and consumer services. Currently, she focuses on deal strategy including commercial and operational due diligence as well as on growth strategies, mainly market entry and strategic option analysis.

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