

I love the company, but what will our synergies look like?

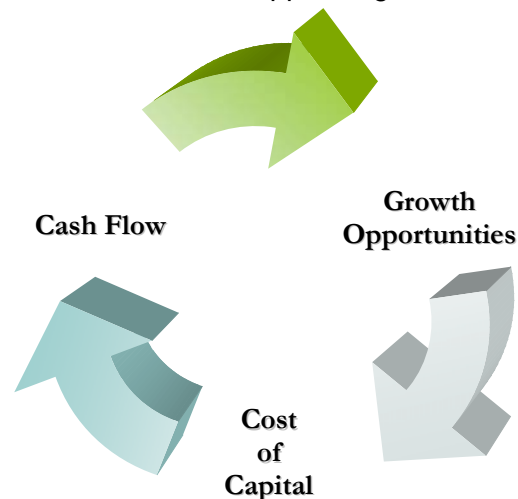
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Companies often find another company that they are interested in buying. One of the reasons for acquiring the company is the potential synergies that can be created by a combination of the two companies. First, let's define synergies. According to The American Heritage® Dictionary of the English Language, Fourth Edition (Houghton Mifflin Company), synergies are:

1. *The interaction of two or more agents or forces so that their combined effect is greater than the sum of their individual effects.*
2. *Cooperative interaction among groups, especially among the acquired subsidiaries or merged parts of a corporation, that creates an enhanced combined effect.*

The above quote was published on Dictionary.com with further commentary from Investopedia.com, which states: “*The idea that the value and performance of two companies combined will be greater than the sum of the separate individual parts.*” The problem with synergies, like babies, is that you can only guess what the “final product” will ultimately look like. For companies involved in an acquisition, the results are often disappointing.

The acquiring company typically believes that it will be able to purchase the target company for a certain price and increase the value of the combined company by an amount greater than the purchase price. In order to accomplish the desired increase in value, it is helpful to understand the areas that affect valuation. The table to the right provides a graphical depiction of the factors that impact the value of a company. Based on this chart, the company would appear to need to find acquisitions so that it can:



- ▶ Increase cash flow – This can be accomplished through reducing costs, increasing revenues or both.
- ▶ Improve growth opportunities - Examples include expanding one company's products into markets where the other company has a presence or combining the sales, marketing and distribution expertise of a company with the technical competencies of the other company.
- ▶ Decrease the cost of capital – This is often accomplished by public companies that have access to cheaper capital than is available to private companies, a financially stronger company acquiring a weaker company, or private equity groups, which acquire a company with cheaper capital and then help the company obtain cheaper financing.

The above sound easy, and are often the very areas that an acquiring company and its advisors identify as benefits prior to an acquisition. So why do acquisitions so often fail to realize the anticipated benefits? As you might expect, the reasons are varied. The typical reasons are as follows:

- Execution – Let me repeat that: EXECUTION! The key reason for failure to realize the synergies is that the management team fails to take the necessary actions to generate those benefits. The reasons for this are many, but one key reason may be that management becomes so consumed by the demands of simply bringing the two companies together that they are unable to execute the plans developed going into the acquisition.
- Faulty assumptions - The acquiring company believes that benefits may occur that will increase cash flow or add future growth to the combined company without considering internal or external factors, which may prevent the assumed benefits from being realized. For example, a company may purchase another company with a complementary product. The company management believes that its customers or the customers of the acquired company will simply purchase the other's products. They fail to realize that the customers may not want those products or the sales force may not want to sell the other products.
- The human element – Employees can absolutely make or break an acquisition. If not handled correctly, employees can torpedo synergies. Acquiring companies typically focus on upper management and making sure they are handled appropriately. However, lower level management and employees may be overlooked, or may be seen more as sources of potential cost savings by reducing the “head count,” rather than as assets to the organization. Such misplaced actions may, in fact, cause negative results.
- Financial leverage – Debt can be very beneficial in helping companies achieve an acquisition and accomplish their goals. However, a company that takes on too much debt can place a great strain on the company's cash flow and prevent the company from investing in the people and assets which are required to achieve the planned results.

Therefore, some keys to achieving synergies from an acquisition are to:

- ✓ Do your homework prior to entering a transaction.
- ✓ Factor in any obstacles that may prevent the apparent synergies from being fully realized.
- ✓ Develop and execute a plan to achieve the desired results.
- ✓ Finance the transaction with the appropriate level of debt and equity that will provide the necessary financing and flexibility going forward.

So what will the synergies look like? That will depend on the successful performance of the steps listed above. Acquiring a company and achieving the potential synergies can be a wonderful experience, but, if not handled properly, the dream of having a beautiful combined company may turn into a nightmare.