

March 29, 2005

MANAGER'S JOURNAL**Five Ways to Spot a Good Deal**By **DAVID HARDING** and **SAM ROVIT**
March 29, 2005; Page B2

Monster deals are back in vogue. In the last five months alone, 13 deals have been announced with valuations totaling more than \$10 billion: Proctor & Gamble/Gillette; UJF/Mitsubishi Tokyo Financial and HEXAL/Novartis just to name a few global giants. And then there's the battle between Qwest and Verizon to acquire MCI.

Every time another behemoth deal is announced, investors quake. History has not been kind to shareholders of mega acquirers. Consider: Of 790 deals greater than \$250 million between 1995 and 2001, only three in 10 have created meaningful value for those shareholders footing the bill. Slightly more than half actually destroyed value. Big deals can be perilous.

Yet, many great companies were built on deals, and many deals clearly are winners. Think of Cisco, the router company, Sysco the food service distributor, and Clear Channel, the global communications firm, to cite three names associated with deal success.


So, after whistling at the size of the latest big deal, how can an investor judge whether a management team is following a prudent course? Our research concludes that deal success is not random. There are clear indicators that investors can use to assess whether they should expect a huge success or a big flop. Investors can handicap their management team's likelihood of success on five criteria:

Is management experienced in deal making? It is a fact that frequent acquirers earn higher shareholder returns than companies that do few deals or none at all. While this may seem paradoxical, we've found that first-time and infrequent acquirers make rookie mistakes that cost their shareholders dearly. Companies with functional expertise in deal making know how to buy and integrate businesses, and it shows in excess shareholder returns. By far the worst returns accrue to companies that do large, one-off acquisitions.

Will the acquisition strengthen the buyer's core? Scale deals -- with big overlaps of operations -- that reinforce the core have good return profiles, but scope deals that take a business into a new direction often disappoint. We found scale deals outperform scope deals by nearly 50% two years out. A management team should be able to articulate how a deal will make the current business better. The stock market is very good at detecting deals with a poor investment thesis. If an acquirer's stock drops more than 10% relative to industry peers on deal announcement, odds are 75% that the price will still be down two years out.

Did management do its homework? Many corporations do weak strategic due diligence. They should learn from the masters, private equity houses like Texas Pacific Group, Blackstone and Bain Capital. Private equity buyers don't assume they know about a business on the market. Corporate buyers tend to "audit" business in industries they know well. The result is myopia on key issues around customer

DOW JONES REPRINTS

 This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit:
www.djreprints.com.

- [See a sample reprint in PDF format.](#)
- [Order a reprint of this article now.](#)

relations, supply arrangements and the inevitable "window dressing."

Is management addressing merger integration issues up front? Bad deals unravel during integration. In our experience with mergers of big equals, blending management teams can lead to fuzzy decision-making. In scale deals, the best integration is both comprehensive and fast, with an open acknowledgment that there will be one cultural acquirer, which may not be the buyer. In scope deals, the best integration is minimal. The vast majority of companies involved in big deals lose market share in the year after announcement. The first priority of merger integration should be to make sure this does not happen.

Is the executive team prepared for the unexpected? No deal comes off exactly as planned. Experienced deal makers install early-warning systems to detect failures in accounting, distribution and customer service. The Kellogg/Keebler merger is often viewed as a great strategic deal. A lot went wrong, but management was expert at making mid-course corrections. The result was upside surprises for investors.

Investors and analysts should ask these tough questions of their executive teams. The data is overwhelming: Experienced acquirers who reinforce their base business, have done their homework and can put businesses together quickly and flexibly earn out-sized returns on mega deals. Executives who do not create bigger problems.

Messrs. Harding and Rovit, Bain & Company partners, are co-authors of "Mastering the Merger: Four Critical Decisions that Make or Break the Deal" (Harvard Business School Press, 2004).

URL for this article:

<http://online.wsj.com/article/0,,SB111206227676891599,00.html>

Copyright 2005 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our [Subscriber Agreement](#) and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com.