

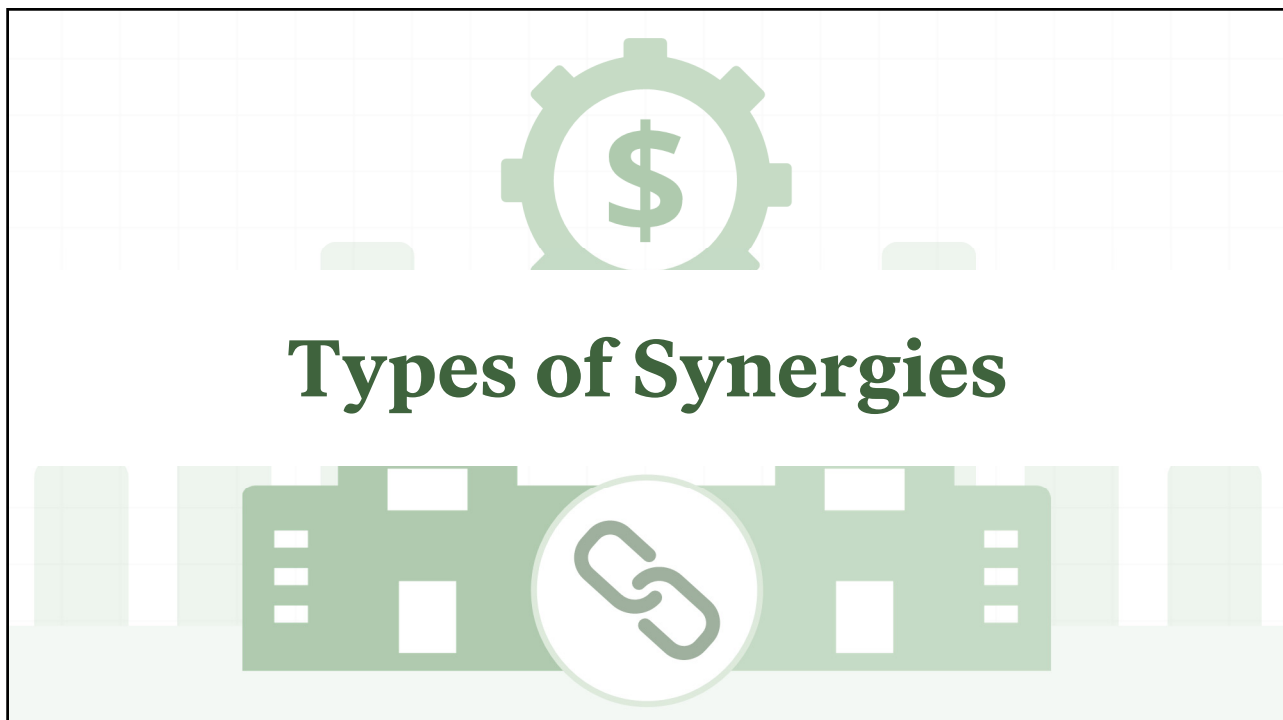
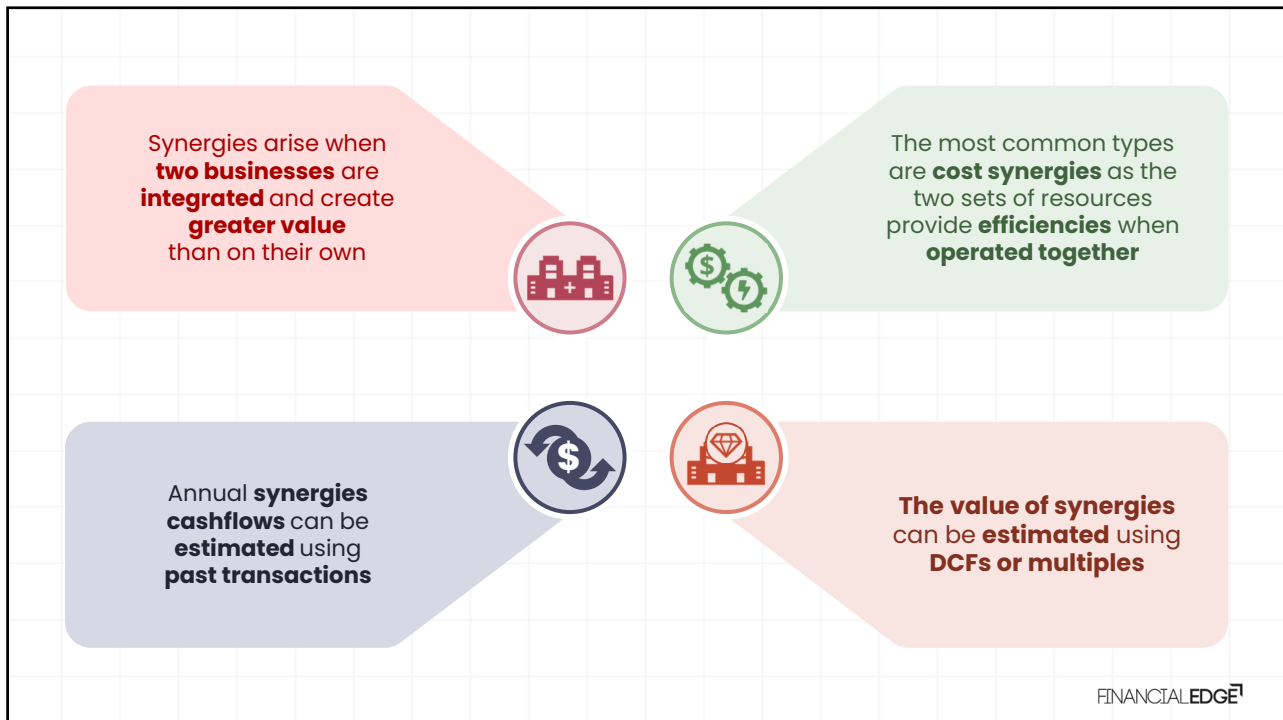


## Synergy Analysis

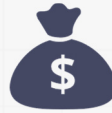
FINANCIALEDGE<sup>1</sup>

## What are Synergies





## Income Statement Synergies



### Revenue Synergies

Selling products to your **merger partner's** customers

#### Tricky to Quantify and Achieve

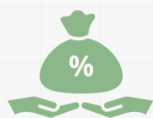
Cannibalization often **underestimated**

#### How to Model?

Simple **addition to sales**, at the **same margin** as the existing business

FINANCIALEDGE<sup>7</sup>

## Income Statement Synergies



### COGS Synergies

Mostly for **deals in the same product category**  
(horizontal mergers/acquisitions)

#### How to Model?

Assume cost savings as a **% of target company revenue** or **combined revenue**

Margins improve



### SG&A Synergies

For **any deal**, but particularly for  
**vertical mergers/acquisitions**

#### How to Quantify?

Depends on the industry and the deal. **5%-10% of target sales**,  
or **2%-5% of combined sales**

FINANCIALEDGE<sup>7</sup>

## Income Statement Synergies



### Tax Synergies

When **acquiring a target** in a low tax jurisdiction

#### How to Model?

When acquirers are able to **channel some parts** of their business over **to the target**, this **increases the profits taxed** at a low tax rate

FINANCIALEDGE<sup>7</sup>

## Income Statement Synergies



### Financing Synergies

Company with **low leverage** buying a company with **high leverage** – **decreases WACC and increases EV**

FINANCIALEDGE<sup>7</sup>

## Non-Income Statement Synergies



There are other **non income statement synergies** that may not immediately **affect earnings per share (EPS)**

FINANCIALEDGE<sup>7</sup>

## Non-Income Statement Synergies



### Operating Working Capital Synergies

These affect **balance sheet items** such as **inventory and receivables**

For example, **companies combine to better manage their inventory** e.g. retailers, sports apparel

FINANCIALEDGE<sup>7</sup>

## Non-Income Statement Synergies



### Capital Expenditure (Capex) Synergies

Combining businesses leads to **less need for capex**

These **reduce outflows** on the **cash flow statement** and result in lower balance sheet assets. If **inflation is high**, **capex synergies** are even **more desirable**

FINANCIALEDGE<sup>7</sup>

## Non-Income Statement Synergies



**Financial markets** tend to focus **on earnings per share (EPS)**, but there are many other synergies that **can drive a deal** and may **not immediately affect EPS**

FINANCIALEDGE<sup>7</sup>

## Non-Income Statement Synergies



**The focus of markets on EPS can cause some companies to stay private, where investors aren't constantly looking for EPS impacts of deals**

FINANCIALEDGE<sup>7</sup>

## Estimating Annual Synergies Using Past Transactions



The **transaction multiples grid** can provide valuable data on **synergies potentially realized in a deal**

From press releases, presentations etc

| ACQUIRER / TARGET | OFFER PRICE | % PREM | ACQ. EQUITY VALUE | ACQ. EV | LTM SALES | LTM EBITDA | EV/LTM SALES | EV/LTM EBITDA | SYNERGIES % OF TARGET SALES |
|-------------------|-------------|--------|-------------------|---------|-----------|------------|--------------|---------------|-----------------------------|
| Co A / Co V       | 13.00       | 30.0%  | 1,300.0           | 1,600.0 | 1,000.0   | 130.0      | 1.6x         | 12.3x         | 12.0%                       |
| Co B / Co W       | 24.00       | 37.0%  | 900.0             | 1,050.0 | 880.0     | 90.0       | 1.2x         | 11.7x         | 16.2%                       |
| Co C / Co X       | 57.45       | 45.34% |                   | 1,650.0 | 1,450.0   | 110.0      | 1.1x         | 17.6x         | 14.1%                       |
| Co D / Co Y       |             |        |                   | 1,500.0 | 1,426.0   | 100.0      | 1.1x         | 13.5x         | 8.1%                        |
| Co E / Co Z       | 6.43        | 25.6%  | 3,480.0           | 4,415.0 | 2,500.0   | 450.0      | 1.8x         | 12.8x         | 7.8%                        |



Synergies usually drive the amount of **premium offered**



The relative amount of synergies from **previous transactions** gives an important insight to **expected synergies in future deals**



When applying percentages from previous deals to estimate synergies, cross check for **comparability of margins, cost structures and industries**



## Valuing Synergies Using DCF





|                                |                                    | YEAR 1  | YEAR 2 | YEAR 3  |
|--------------------------------|------------------------------------|---------|--------|---------|
|                                | <b>PRE TAX SYNERGIES</b>           | 100.0   | 200.0  | 300.0   |
| Use Target MTR                 | <b>POST TAX SYNERGIES @ 30.0%</b>  | 70.0    | 140.0  | 210.0   |
| Target WACC + risk premium     | <b>DISCOUNT RATE</b>               | 10.0%   |        |         |
| Could assume perpetuity growth | <b>TV (NO GROWTH)</b>              |         |        | 2,100.0 |
|                                | <b>DISCOUNT FACTORS</b>            | 90.9%   | 82.6%  | 75.1%   |
|                                | <b>PV OF SYNERGIES</b>             | 63.6    | 115.7  | 157.8   |
|                                | <b>SUM OF PV OF SYNERGIES</b>      | 337.1   |        |         |
|                                | <b>PV OF TV</b>                    | 1,577.8 |        |         |
|                                | <b>VALUE OF SYNERGIES</b>          | 1,914.9 |        |         |
|                                | <b>TOTAL PREMIUM PAID</b>          | 2,300.0 |        |         |
|                                | <b>VALUE CREATED / (DESTROYED)</b> | (385.1) |        |         |

Total premium paid to **target shareholders**, for public companies acquisition equity value – pre offer market cap

If premium paid < value of synergies, **transaction creates value for acquirer shareholders and visa versa**

FINANCIALEDGE<sup>7</sup>

## Valuing Synergies Using Multiples



