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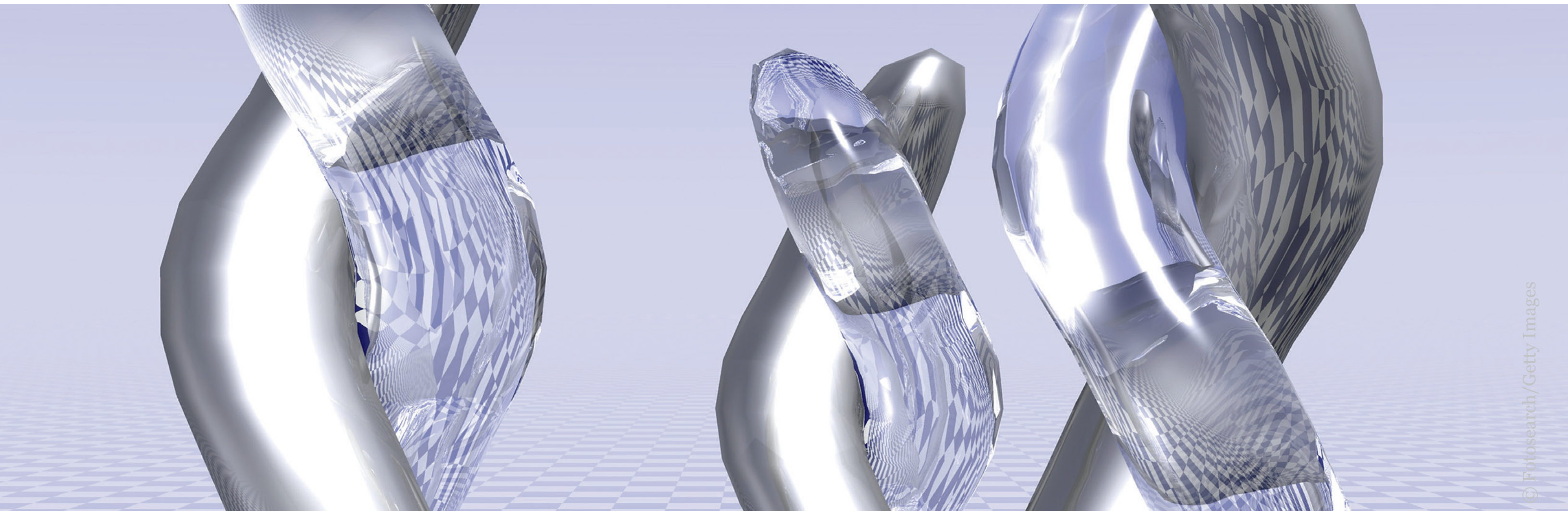


Corporate Finance Practice

Creating value from M&A—advantage Asia?

Differences in the market's response to deal announcements reflect how deals are funded as much as expected performance.

Anushree Awasthee and David Cogman

The total value of corporate M&A activity in Asia[1] is substantially less than in the United States and until recently also lagged behind Europe. Equating experience with ability, many Asian companies assumed that their meager track record relative to Western companies would lead the capital markets to take a skeptical view of their deals.

It's an assumption we often still encounter among Asian deal makers who hesitate around M&A decisions—and it's unwarranted. Deal-making experience has grown with the hectic volume of activity in the region since 2012. Volume in Asia virtually matched that of Europe in 2015, comprising nearly a third of global M&A activity.[2] And a closer look at announcement effects[3] finds that capital markets have long ago put aside their skepticism about Asian deals.

For one, they have more consistently rewarded Asian acquirers, on average, than Western acquirers for the value their deals are expected to create. In 10 of the 16 years since the turn of the millennium, the average deal value added (DVA)[4] for Asian acquirers was positive, compared with just 6 of the 16 years for acquirers in Europe and only 3 for those in the United States.

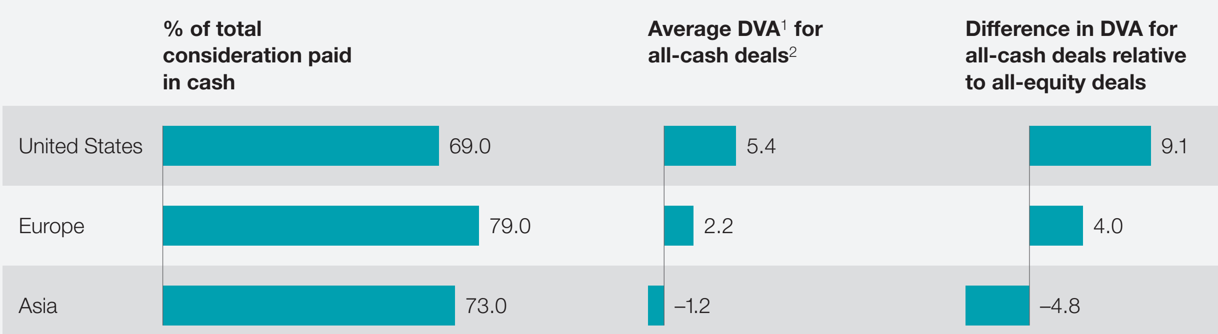
For another, differences in the market's response to deal announcements in different regions reflect how deals are funded as much as expected performance. Deals in the United States have, overall, enjoyed a 9.7 percent increase in DVA since 2010, which is far higher than the 2.9 percent increase in Europe and the 1.7 percent increase in Asia. But this difference largely reflects the market's response to the use of cash or equity in the different regions. While US and Asian acquirers tend to use almost the same amount of cash—and all three regions have used more cash since 2009 as quantitative easing made cash cheaper—equity markets have rewarded US cash deals much more aggressively (Exhibit 1).

This is in large part because US companies have found themselves cash rich, with an estimated $2 trillion on US balance sheets kept offshore mostly to defer the tax liabilities of repatriating it.[5] The capital markets are effectively rewarding US companies for reducing their cash holdings. Stock-only deals are not affected by this and offer a more useful point of comparison for investor expectations of M&A in different regions. It is here that Asian companies have done the best, with an average DVA that has been positive even when that of other regions was not (Exhibit 2).

It is important to remember that these numbers do not measure deal success: they just tell us whether the equity markets expected the deals to create value when they were announced. Why, then, did the markets have such a positive view of Asian acquirers, given the widely held belief that they lack the experience of their US or European counterparts?

One possible reason is that if investors perceived Asian companies to lack experience, they didn't see it as a negative. Instead, they may have expected it to lead Asian companies to avoid risky deals that companies in other regions might have executed. Another possibility is that their options for creating value are simply different: a Chinese acquirer of a German company might be able to reduce costs by relocating manufacturing in a way that a US

Exhibit 1 **Markets responded more positively to the all-cash deals of US acquirers than those of European or Asian acquirers from 2010 to 2015.**

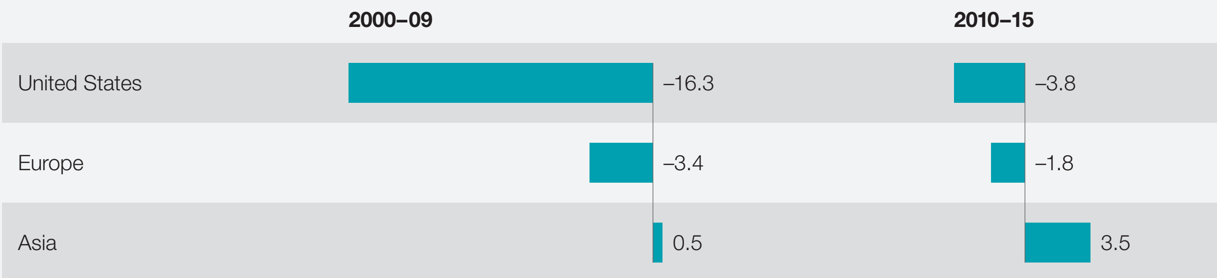


[1] Deal value added.
[2] For M&A involving publicly traded companies; defined as combined (acquirer and target) change in market capitalization, adjusted for market movements, from 2 days prior to 2 days after announcement, as % of transaction value.

Source: Datastream; Dealogic; McKinsey analysis

Exhibit 2 **Investors have long responded better to all-stock deals in Asia than elsewhere.**

Average DVA[1] index for all-stock deals,[2] %



[1] Deal value added.
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Source: Datastream; Dealogic; McKinsey analysis

acquirer could not, or perhaps would gain more from the new sales channels.

Whatever the reason, Asian acquirers hesitating over how capital markets will view an acquisition should take some degree of comfort from these numbers. It is impossible to say how equity markets will view any individual deal, but in general, they do not lack confidence in Asian companies' ability to create value from acquisitions. ■

[1] Our analysis is based on unweighted regional data from Australia, China, India, Indonesia, Japan, Malaysia, Singapore, South Korea, Taiwan, Thailand, and Vietnam.
[2] Werner Rehm and Andy West, "M&A 2015: New highs, and a new tone," December 2015, McKinsey.com.
[3] The change in the acquirers' and targets' market capitalization directly before and after deals are announced.
[4] For M&A involving publicly traded companies, deal value added is defined as the combined (acquirer and target) change in market capitalization, from two days prior to two days after the announcement of a deal, adjusted for market movements as a percent of transaction value.
[5] See Richard Rubin, "US companies are stashing $2.1 trillion overseas to avoid taxes," *Bloomberg*, March 4, 2015, bloomberg.com; and "The risks and rewards of a US tax on offshore cash," *Financial Times*, February 4, 2015, ft.com.

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