

Are you giving  
M&A integration  
costs the attention  
they deserve?

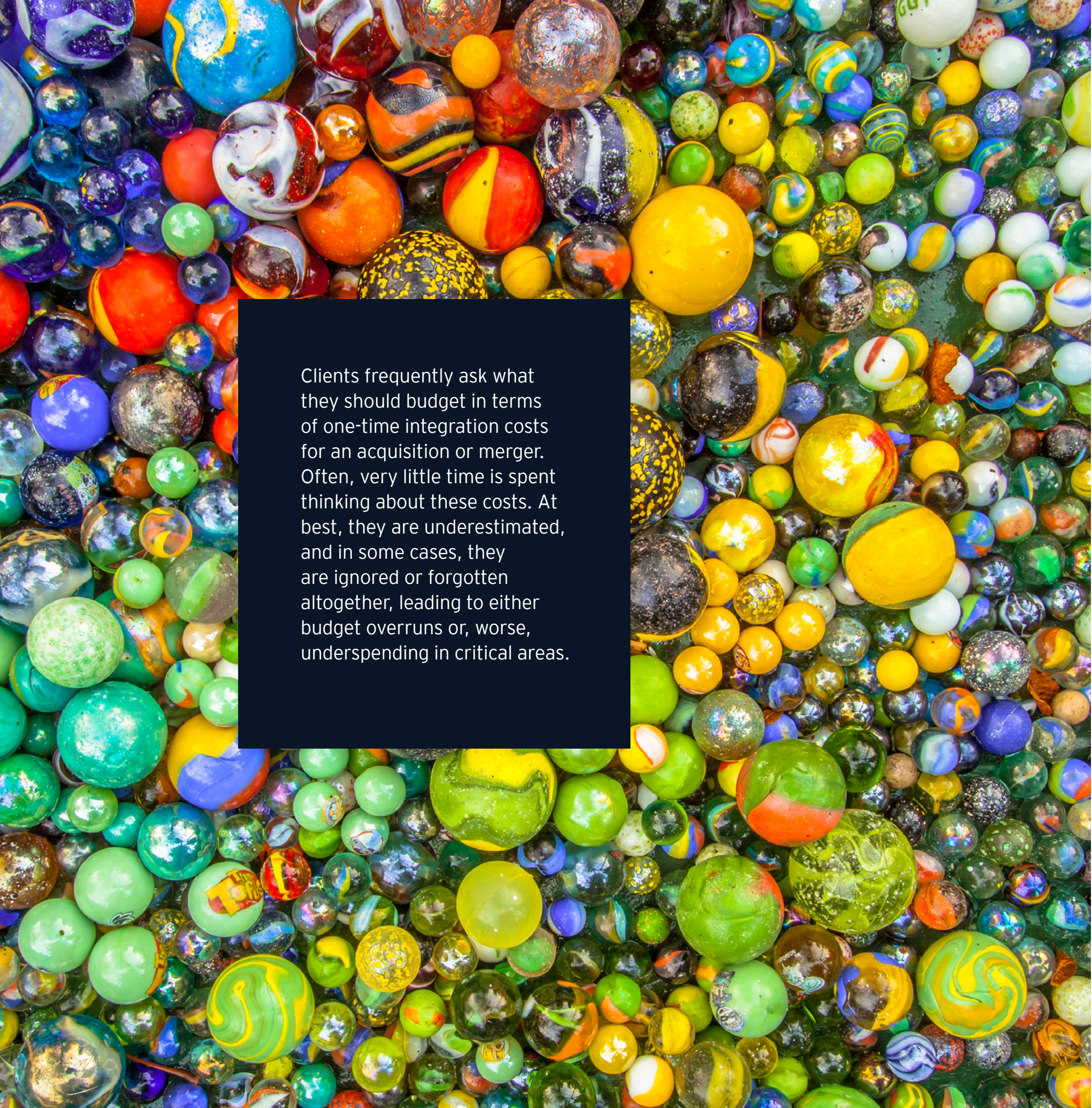


The better the question. The better the answer.  
The better the world works.



Building a better  
working world



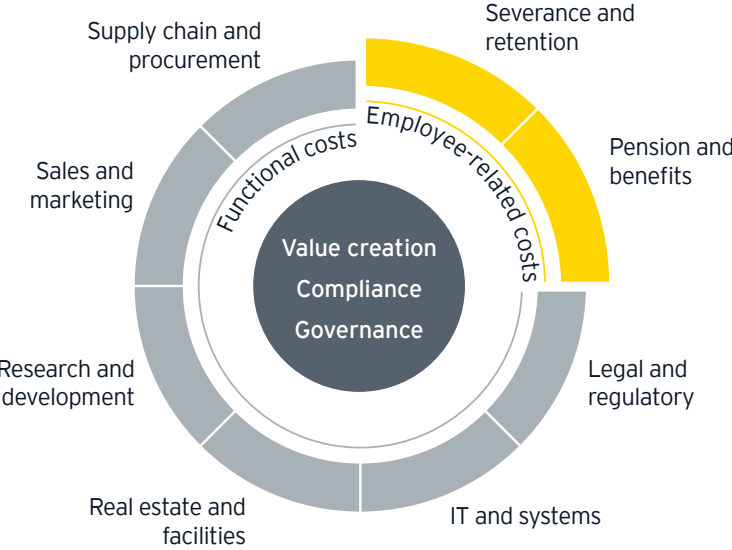


Clients frequently ask what they should budget in terms of one-time integration costs for an acquisition or merger. Often, very little time is spent thinking about these costs. At best, they are underestimated, and in some cases, they are ignored or forgotten altogether, leading to either budget overruns or, worse, underspending in critical areas.

# Integration costs

Although it might seem intuitive to estimate integration costs based solely on deal size, our extensive research and experience reveal that costs are much more indicative of the degree of change required in the integration plan rather than the sheer transaction size. Put another way, change is the key driver of integration costs, as exemplified in three areas:

1. Cost savings targets (and, to a lesser degree, revenue or growth synergy targets)
2. Regulatory or compliance-related adjustments resulting in changes to legal entities, reporting requirements, risk mitigation or redefined quality standards
3. How much integration governance and third-party support are required to make the integration a success



We reviewed more than 70 deals\* (announced, closed or effective mergers and acquisitions) from 2010 to 2016 valued at over US\$1b each with publicly listed buyer companies. The range of publicly reported integration costs was very wide – from US\$4m at the low end to US\$3.8b at the high end.

While every deal is different, we observed four trends around integration costs.

\*Deals in the financial services and real estate industry, deals with multiple buyers, private equity firm acquisitions and deals in which the buyer is headquartered outside the US were excluded



# 1

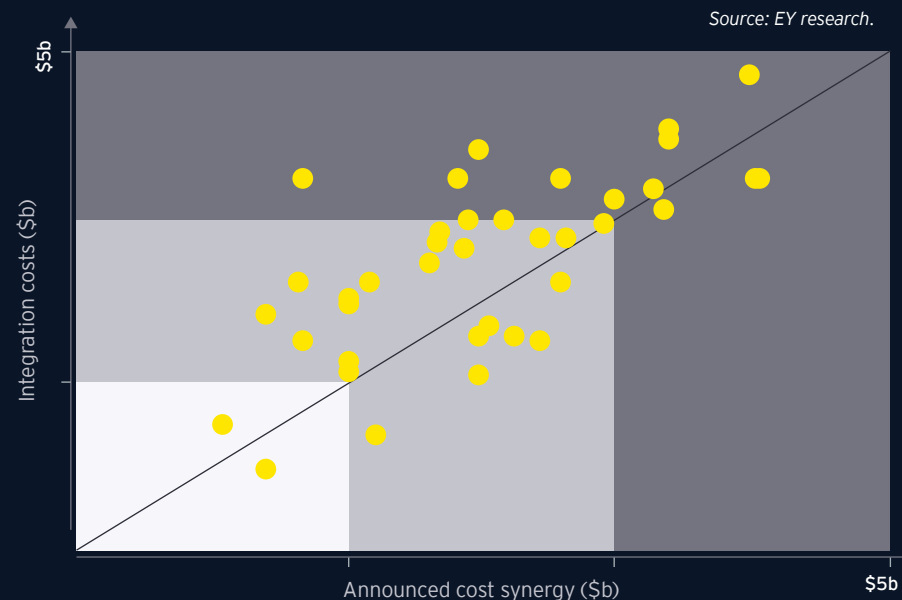
The best measurement of the degree of required change is the **size of the synergy target** – synergies represent the most direct correlation with integration costs.



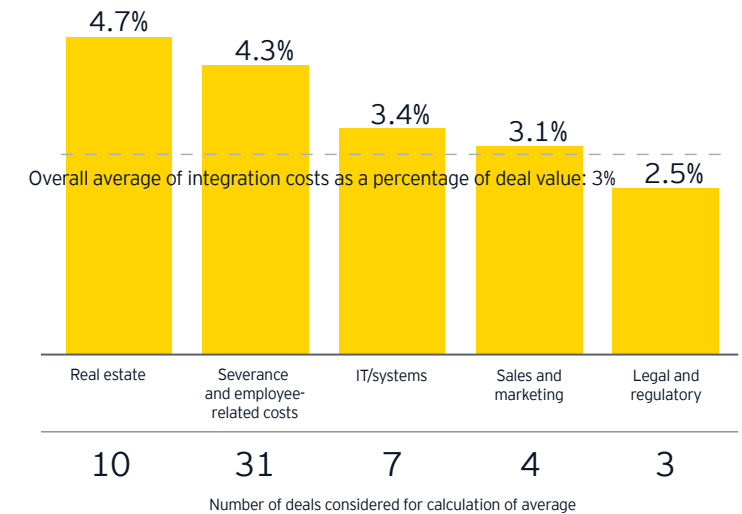
More specifically, capturing synergies requires making changes to the current operating model, technology, workforce, infrastructure and other elements. Typically, the more that change is desired, the more spending will be needed – at least in the near term. Reducing the number of employees, shutting down a headquarters, rebranding the company or consolidating the supply chain all result in significant costs. So, it is logical that the higher the synergy target, the greater the change needed and the more it costs to get there. According to the *EY Global*

*Capital Confidence Barometer* survey published in October 2018, companies that spent more on the integration process outperformed their pre-deal targets. In fact, those companies that met or exceeded their original synergy targets spent on average 8% more (as a percentage of announced synergies) than those that failed to meet their ambitions. Being willing to spend money to save money seems to make sense in this case.

Correlation between announced cost synergy and integration costs



Average integration costs as percentages of deal value by drivers



Source: EY research.

# 2

The most frequently reported drivers of **one-time integration costs** are severance and employee-related costs, plant, office or real estate shutdown and IT system changes.

Severance costs that the buyer pays account for more than 50% of integration costs in certain deals, according to EY research. This one-time “hit” has an annuity-like payback from cost savings for the foreseeable future. Given that such costs often creep back in over the near term, it is critical to track these cost synergies for at least three to five years post-close.

Building scale and breaking into new markets are some of the main reasons for an acquisition. These acquisition drivers often bring new talent into a business because operating in a new market may require skills and local knowledge that the acquiring company lacks. Companies may need to place more emphasis on the talent that they are acquiring and put the resources in place to secure the commitment of individuals who are essential to the organization’s future success.

Real estate activities (shutting down properties, moving offices, and reconfiguring locations) drive integration costs but are not reported as frequently as other costs. IT costs, such as licensing, consultant and reconfiguration fees, round out the top three integration cost drivers.







# 3

## Deal size has some bearing on integration costs – but only loosely. Despite deal size, **integration costs can range from 1% to 7% of deal value.**

According to EY research, deals valued above US\$10b incur, on average, lower integration costs than deals valued below US\$10b, measured as a percentage of deal value. In the deal value range of US\$5b to US\$10b, the integration costs ranged from 1% to 5% of the deal value. In the lower deal value range of US\$1b to US\$5b, integration costs increased to 2% to 7% of the deal value. In reality, this range is too large to be predictive.

The tendency for integration costs to increase marginally when the deal size goes down could be because larger deals are oftentimes scale deals in which a company is buying a direct competitor and can more easily integrate its similar products, services or facilities. In some smaller deals – for example, the purchase of a smaller company that makes an innovative product – the costs to integrate a dissimilar business can increase in

terms of percentage of deal value. The real reason small deals are more expensive than bigger deals is likely that there are many fixed integration costs not linked to deal size (e.g., costs of regulatory filings, IT-related fees and management consulting fees).

# 4

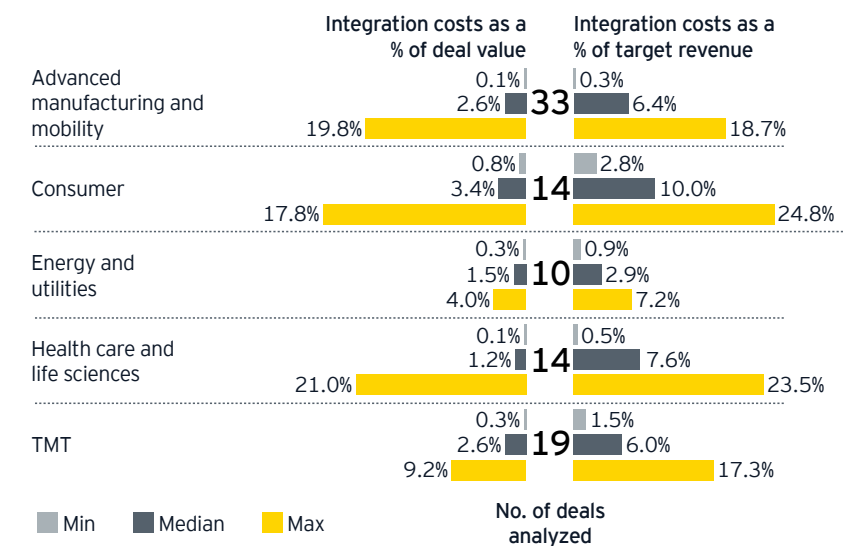
## Integration costs **vary by sector.**

Certain sectors we studied illustrate variances in integration costs in relation to deal value as well as target revenue. For example, consumer, health care and life sciences sectors show higher integration costs relative to deal value and target revenue, compared with the energy and utilities, and technology, media and telecommunications (TMT) sectors. Hence, the integration costs for a deal might vary if we look at them from the lens of the target sector. Here are some examples:

- ▶ In the consumer sector, integration costs tend to be driven by deals in the consumer products subsector that focus on product innovations, as opposed to deals in the retail space, which hover around operational efficiencies.
- ▶ In health care and life sciences, the integration cost median was at 7.6% of target revenue, possibly driven by compliance with regulatory, safety and quality standards, as well as consolidation of the research and development function.

▶ The energy and utilities sector has the lowest integration costs overall, with a median of 2.9% of target revenue. This could be because most acquisitions happen within the sector rather than as cross-sector investments. For example, oil and gas acquisitions tend to be for oil fields and rigs – strategic fixed assets – which can easily be added to the buyer’s portfolio.

▶ Lastly, a sector with significant deal activity is the advanced manufacturing and mobility sector, where most reported transactions involve integration costs of more than 6% of the target revenue. This higher level of integration costs can be linked to several subsector dynamics, such as the amalgamation of manufacturing facilities by chemical companies and the streamlining of administrative functions and infrastructure by automotive and transportation companies.



Source: EY research.

## Conclusion

When considering an integration, the best predictor of integration costs is the size of the synergy target. Companies would be better served by realistically calculating costs to achieve these targets, as well as including the cost of the expertise required to successfully execute the transaction.

The EY organization has done extensive research on this topic. For a deeper dive into these findings, please contact Brian Salsberg, EY Global Buy and Integrate Leader, or your EY representative.

# EY Contacts

EY | Assurance | Tax | Transactions | Advisory

## Global

### **Brian S. Salsberg**

EY Global Buy and Integrate Leader  
brian.salsberg@ey.com

## Americas

### **Mayur Goyal**

Partner, Transaction Advisory Services  
Ernst & Young LLP  
mayur.goyal@ey.com

### **Ron Charles**

Managing Director, Transaction Advisory Services  
Ernst & Young LLP  
ron.charles@ey.com

## EMEIA

### **Jasper Knol Bruins**

Partner, Transaction Advisory Services  
Ernst & Young LLP  
jasper.knol.bruins@nl.ey.com

## Asia-Pacific

### **Stella Yuan**

Partner, Transaction Advisory Services  
Ernst & Young LLP  
stella.yuan@cn.ey.com

## Contributors

**Rahul Kumar Agrawal, Banipreet Kaur and  
Deepanshi Jerry**

## About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via [ey.com/privacy](http://ey.com/privacy). For more information about our organization, please visit [ey.com](http://ey.com).

© 2019 EYGM Limited.  
All Rights Reserved

SCORE no. 004139-19GbI  
1907-3225346  
ED none

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax or other professional advice. Please refer to your advisors for specific advice.

[ey.com](http://ey.com)

