

# THE (OCCASIONAL) CASE FOR M&A

ALAN EDINGTON, INVESTMENT MANAGER AND SUSTAINABILITY INTEGRATION
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## KEY TAKEAWAYS

- Historically, we have maintained a healthy scepticism around the promises of M&A
- However, there are always exceptions. M&A can create value and underpin long-term growth
- Well-financed cash generative companies are often well-placed to make timely acquisitions

Proclamations that international equities are the place to be are becoming hard to miss. During February, calls from an array of investment commentators and pundits urging investors to consider opportunities beyond the highly valued US equity market grew yet louder. We don't disagree.

Where our perspective differs, however, is that we have long believed in the outlook for the best companies outside of North America. For us, this is far more than a fleeting market call or enticing soundbite. It is a belief grounded in our company research and our long-term investment outlook.

Having applied the same investment philosophy and process for over 40 years, important lessons can be drawn around investment cycles and economic conditions. We can also apply that experience when judging corporate behaviour, honing our ability to find companies that will meet our long-term investment objectives.

Over the years, we have steered away from companies that are subject to cyclical forces without a clear tailwind for long-term growth behind them. We have also tended to avoid companies with overly complex or opaque financing

arrangements, and we have maintained a healthy scepticism around the promises of M&A.

## LEARNING LESSONS, NOT SETTING RULES

Yet these lessons are not rules. We use them to guide, not constrain, our decision making. There will always be exceptions. Take M&A. Countless academic studies have questioned whether many acquisitions create value. We have learnt to treat estimated savings courtesy of synergies with a pinch of salt, likewise, ambitious timelines for the integration of businesses. But with "The Art of the Deal" very much in focus in February, it seemed timely to consider companies where M&A has been a success and where acquisition-led growth is an important part of their long-term growth outlook.

## THE CASE FOR BOLT-ON ACQUISITIONS

Compass is one example of a company where bolt-on acquisitions have created rather than destroyed value and been an important contributor to growth over the years.

In February, the CFO and Head of IR joined one of our research meetings to provide an update on the company's strategic outlook and take questions from the team. As we have become used to from Compass, the message from the CFO, Petros Parras was reassuringly consistent. In this conversation and in our previous meeting with him in November last year, we heard about management's focus on achieving the right balance between buybacks and M&A, and delivering growth through both organic growth and acquisitions.

Europe remains an area of focus for the company. With market share currently 7%, management believes there is scope for growth. Having spent $1.7bn in 2024 on a series of acquisitions across Europe to tap into outsourcing demand, they have mapped out further new business opportunities across the company's top 10 European markets indicating that there will be more M&A as they pursue opportunities in interesting sub-sectors.

Sage Group is another example of a company where the consensus view on the value of M&A does not, in our view, apply.

Sage is a leader in accounting, financial, HR and payroll technology for small and medium sized enterprises (SMEs). For its customers, Sage's services deliver efficiency, accuracy, regulatory compliance, systems integration and business analytics. For companies that might still be relying on Excel spreadsheets or even pen and paper book-keeping, these benefits can be significant.

Sage has shown that the value delivered through its services and solutions builds loyalty and long-term customer relationships. The company's success has also come from its ability to continue to improve and augment its services. M&A has been an important part of that development.

Just taking the final quarter of 2024, Sage announced two deals that very much reflected its strategic gameplan. The company acquired Barcelona-based ForceManager, a tool that supports SME sales teams to improve efficiency and productivity. This deal was very much in Sage's wheelhouse in delivering AI-enhanced tools that help its clients enhance their day-to-day operations. ForceManager was also already part of the Sage partner ecosystem, giving the company meaningful insight into the merits and customer appeal of its offering.

Sage also acquired Anvyl, a New York-based technology firm, in the fourth quarter. Anvyl's supply chain software will augment Sage's existing Supply Chain Execution solution and in turn provide customers with greater visibility across their supply chains from purchase order to warehouse management. Supply chain transparency and control is an area of growing complexity and importance and so this deal should position the company well to tap into the evolving needs of its customer base.

## ORGANIC AND ACQUIRED GROWTH

UK-based Halma consists of a group of businesses making equipment that protects human lives, infrastructure assets and natural resources. Halma's products are ubiquitous. They range from medical products and diagnostic equipment found in hospitals and laboratories, to fire detection systems and elevator safety devices within office buildings and shopping centres.

Growth across these areas has been, and will continue to be, underpinned by regulation, urbanisation and growing climate change requirements amongst other long-standing shifts. A large part of its success and growth has also come from identifying and acquiring businesses that add expertise and exposure to these specialist fields.

Acquisitions remain central to the company's growth plans with a targeted 10% annualised earnings per share growth over the long term, split evenly between organic and acquired growth.

The company's January investor event – titled "How we do M&A" – was a chance to hear from members of Halma's M&A team as well as the divisional heads who play an important role in identifying acquisition targets and ensuring the success of these deals. It was of no surprise that the company was keen to stress its robust due diligence processes, but discussion of its investment timeline was also striking.

Strategically, the case for any acquisition must stack up on a 20-year view, with robust financial modelling over a 10-year horizon.

With the company's 40-year history and 170 deals to date, experience also counts for a lot. Management outlined what

they look for and what they don't want. Attractive niches alongside differentiated solutions and products are high on their wish lists.

They don't want turnarounds. Instead, they are looking for successful smaller companies with the potential to take the next step. They don't want deals presented by investment bankers. They are looking to buy companies that aren't up for sale.

Halma's decentralised approach and its belief in preserving the culture and spirit of any acquired company were noted. Integration, they explained, is not a word they use. This all means that Halma becomes an acquirer of choice, which in turn lessens the risk of competitive bids and keeps deal multiples more reasonable than they might otherwise be.

## MORE SELLERS THAN ACQUIRORS

Acquisitions are also central to the growth outlook for another European company, Italian pharmaceutical group, Recordati. The company develops, manufactures and markets a range of medications and drugs, with over 400 prescription and over-the-counter products.

In its rare diseases division, it owns a collection of fast growing and highly profitable franchises treating ultra-rare and typically highly debilitating diseases. Those include rare metabolic diseases often caused by several genetic defects and oncology treatments for high-risk neuroblastoma patients.

These businesses have all grown through a combination of organic growth and the acquisition of small to medium sized drug franchises. Disposals of non-core but still valuable assets from Recordati's larger peers have proved to be a particularly fruitful acquisition strategy over the years.

As with Halma, Recordati relies on its strong cash generation to fund these deals and it also makes the most of its management's expertise and lines of sight into niche pharmaceutical fields. The pipeline of drugs available for acquisition in the mid-sized deal range is rich. There are, however, few players with Recordati's business model and financial resource. Thanks to those attributes the company has repeatedly shown itself able to acquire the drugs and treatments that it really wants rather than compete against others over many possible deals.

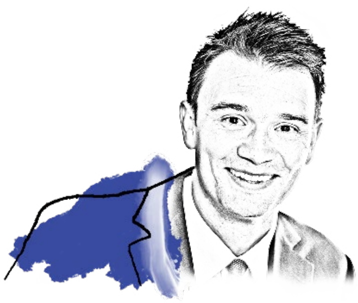
## ASTUTE M&A

On a much larger scale, LVMH is also an example of successful M&A over many years. This luxury giant has been built on a series of acquisitions. Some of its more recent deals have allowed the group to extend into new luxury markets, such as travel and leisure through the purchase of Belmond. Others, such as the landmark acquisition of Tiffany, have cemented the group's leadership in a key growth market. Long-term planning is something that stands LVMH apart and that timeframe is something that has been very much in evidence in its dealmaking over the years.

In February, however, the focus was instead on disposals. Management quashed rumours of a planned sale of Moët Hennessy but declined to comment on the sale of its retail business, DFS. LVMH has previously shown itself to be as adept at disposals as it has been with acquisitions, with the sale of its cruise business in 2023 being just one example. So, watch this space.

## CRITICAL THINKING

We have always treated M&A announcements with a degree of scepticism. That initial response is unlikely to change. But we won't ever write deals off. Across our research framework – our seven sisters – we challenge what companies are telling us, as well as our own analysis. We will always judge a company on its individual merits. So we will continue to scrutinise dealmaking from that perspective. We recognise that whilst many will fail to meet expectations, the right deal, approached in the right way, can deliver just the kind of growth we look for.



**ALAN EDINGTON**

Alan is an Investment Manager and oversees Sustainability Integration. He is also a member of the Investment Management Committee. Prior to joining the firm in 2012, he worked at ManoCap, a private equity firm based in Sierra Leone, and as a lawyer at Slaughter and May. Before university, Alan undertook an extended internship at Walter Scott. He holds a BA (Hons) in Law from the University of Oxford. Alan is a CFA charterholder.

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## STOCK EXAMPLES

The information provided in this article relating to stock examples should not be considered a recommendation to buy or sell any particular security. Any examples discussed are given in the context of the theme being explored.

WALTER SCOTT & PARTNERS LIMITED, ONE CHARLOTTE SQUARE, EDINBURGH EH2 4DR
TEL: +44 (0)131 225 1357 · FAX: +44 (0)131 225 7997
WWW.WALTERSCOTT.COM

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