Acquisitions Are Not Always as Great as They Seem

Description

Management always makes their acquisitions sound good. They probably do believe those acquisitions will add value or be accretive. If not, they wouldn't be making the acquisitions at all.

However, reality is harsh sometimes, as we'll see with the **Maxar Technologies's** (TSX:MAXR)(NYSE:MAXR) acquisition.

Maxar was formerly known as MacDonald Dettwiler and Associates (MDA). It rebranded itself as Maxar after it completed the purchase of DigitalGlobe for US$2.4 billion (CAD$3.1 billion) in October 2017.

The estimated benefits of the acquisition

When MDA announced that it'd acquire DigitalGlobe in late February 2017, it believed the combined company would offer enhanced, value-added services to global commercial and government customers. Additionally, it thought it would expand market access, increase scale, and diversify revenue and customer base.

More concretely, MDA expected the transaction to be accretive to operating earnings per share in 2018 and anticipated it to deliver $75-150 million in run-rate Synergies by 2019.

The actual "value creation"

Fast forward to today from February 2017, the stock has lost close to 90% of its value.

MAXR data by YCharts. The price action of TSX:MAXR from February 24, 2017, to today.

It turned out the operating earnings per share weren't accretive but are expected to decline for 2018. Moreover, they're expected to decline even more this year after Maxar lost one of its satellites.

Furthermore, Maxar took on a lot of debt to acquire DigitalGlobe. Its long-term debt at the end of 2016 was about US$602 million. At the end of 2017, it was US$3.02 billion. At the end of September 2018, it was US$3.17 billion. So, the long-term debt is not showing any signs of declining.

Maxar's debt-to-equity ratio is on the high side at 1.8. S&P has given Maxar a credit rating of BB-, which is not investment grade. The interest rate paid by companies with poor credit ratings is much higher than companies with good credit ratings. So, it's costly for Maxar to pay high interests on its debt.

Instead of value creation, Maxar had massive value destruction. And it's the shareholders who lose money.

Lesson learned

Management can make acquisitions sound wonderful. In most cases, the relevant stock might pop in the short term due to the good news of an acquisition that is supposed to generate additional value. If the merger is executed poorly or if the acquisition isn't as good as initially thought, usually within a year, the stock will underperform. In Maxar's case, it was a huge loss.

So, next time a company acquires another, take a step back and just watch from the sidelines for six months to a year after the acquisition completes to avoid losing money. After all, the goal of investing is to generate returns with the bottom line of capital preservation.

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