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Accretive Shmacretive

When a deal happens, you'll often hear acquiring management announce something to the effect that the transaction is expected to be "accretive" to earnings within some period of time. This means that the combined business will show some incremental improvement in earnings per share eventually. If you don't think much about it and you are not on top of the accounting rules, the quick impression is that the deal made sense and that shareholder value is right around the corner.

What some people do not appreciate is that this hurdle got much easier in 2002 when goodwill (purchase price in excess of recognizable assets) and many name/brand assets ceased to be amortized. The result is that for many deals purchase price and earnings per share are only marginally correlated.

So when you see deals done at outrageous multiples and there is no statement that the deal will be accretive, you know it must be awful. Under the revised rules, every deal worth doing should be accretive on day one.

A handwritten signature in black ink, appearing to read 'John S. Ellis'.

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