Vol. 3, No. 4 **Fall 2006**

Dealmaker

Providing business owners and managers
with M&A market insight

In this issue

1 2006 mid-year market update
2 Preparing a business for sale
3 Deal of the quarter
4 Grant Thornton Corporate Finance News

Dealmaker is published quarterly by Grant Thornton LLP, the U.S. member firm of Grant Thornton International, one of the six global accounting, tax and business advisory organizations. Through member firms in 112 countries, including 50 offices in the United States, the partners and employees of Grant Thornton member firms provide personalized attention and the highest quality service to public and private clients around the globe.

This newsletter is not intended to answer specific questions or suggest suitability of action in a particular case. For additional information on issues discussed in the newsletter, consult your Grant Thornton client-service partner or **George Shaw**, George.Shaw@gt.com, managing director of Grant Thornton Corporate Finance LLC.

To subscribe to an electronic version of ***Dealmaker***, fill out the online request form at www.grantthornton.com/dealmaker.

Editor: Alison Oestermeyer, editors@gt.com

www.grantthornton.com

Grant Thornton LLP
US member of Grant Thornton International

© 2006 Grant Thornton LLP
All rights reserved.

2006 mid-year market update

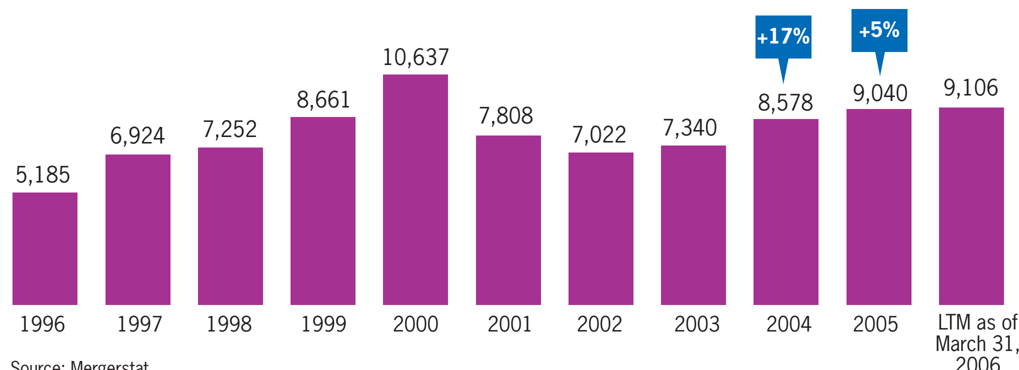
According to Mergerstat™, 9,040 net merger & acquisitions (M&A) transactions were announced in 2005, representing a five percent increase over 2004 and the highest recorded level since the 2000 peak. Activity thus far in 2006 remains robust, with year-to-date transaction announcements up slightly over the comparable period in 2005.

"We are in the midst of one of the strongest M&A cycles the market has ever seen," says George Shaw, managing director of Grant Thornton Corporate Finance LLC. "Heightened activity is being driven by strong corporate earnings coupled with aggressive interest by U.S. strategic buyers, foreign acquirers, and, most importantly, private equity investors. With all of these players converging on the market at the same time, valuations have risen to the highest levels in years," he concludes.

The most active broad industry sectors continue to be consumer, information technology and industrials, which collectively make up roughly 60 percent of all reported deals. However, certain smaller sectors have recently been experiencing explosive growth in M&A, specifically the health care (up 30 percent), energy (up 39 percent) and materials (up 53 percent) sectors.

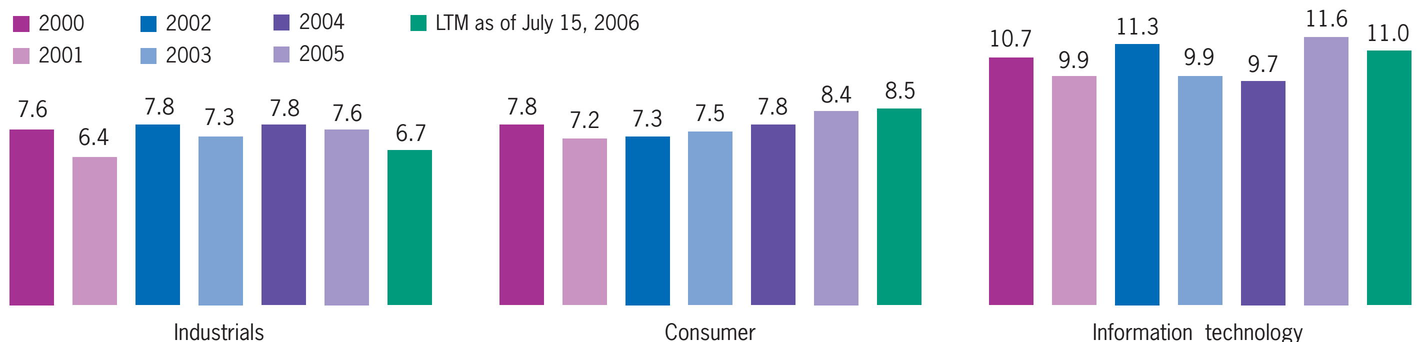
Mid-market M&A valuations remain at extremely high levels in 2006, though median pricing has fallen a bit from the lofty levels of 2005. The median enterprise value to the earnings before interest, taxes, depreciation and amortization (EBITDA) multiple was 9.0x in the trailing 12 month period ended July 15, 2006, as compared to 9.7x for 2005. However, it is important to note that valuation multiples can and do differ widely >

Net M&A announcements - U.S. targets only



Source: Mergerstat

Median EV/EBITDA multiples - transactions between $10MM - 200MM



by industry, with multiples in the consumer and industrial sectors significantly lower than those in the information technology and health care sectors.

Interestingly, international buyers have become increasingly more important in the market. In 2005, approximately one in five U.S. companies sold was acquired by a foreign buyer. Companies from Canada, the United Kingdom, Japan, France, and Germany have been the most active in acquiring U.S. companies.

Also relevant is the sheer number of U.S. companies being acquired by private equity investors. Based on Grant Thornton Corporate Finance LLC estimates, approximately 20 percent of transactions in the United States were private equity backed in 2005. “A sale to a private equity investor can be the ideal liquidity solution because the company’s legacy, its management team, corporate strategy and employees are typically preserved intact,” says Christopher Kampe, Grant Thornton Corporate Finance LLC director. Contrast this approach with a sale to a strategic acquirer, who may seek to integrate a company (and its employees) into an existing operation to achieve cost synergies. Perhaps more importantly, financial buyers can, and in many cases do, pay prices higher than strategic offers. “The gap between the valuations paid by private equity groups and strategic acquirers has closed, particularly in the consumer and industrial sectors,” says Kampe. ■

Preparing a business for sale

By Christopher Kampe, Grant Thornton Corporate Finance LLC director

An estimated 4.5 million owners of privately held businesses are over the age of 50. As these individuals begin to retire over the next 10 years, the ownership of many companies will be changing. If you are a business owner and retirement is on your agenda within the next five years, it may be high time to begin preparing your business for sale.

Why prepare?

Just as a home owner may fix a roof, install a bathroom or add a fresh coat of paint to maximize curb appeal and make selling a home easier, there are several steps that can be taken to ease the sale of a business. Good preparation prior to sale can make your business more attractive, thus increasing interest from potential buyers and these high interest levels can facilitate multiple bids and stimulate higher sale proceeds.

Applying valuation theory to maximize selling price

Businesses are valued based on a buyer’s expectations of its future cash flows, along with their assessment of risk of the venture. Generally, a buyer can only afford to pay that price which, along with an appropriate return on the investment, can be recovered over the economic life of the enterprise through future operating cash flows. In this respect, to maximize the value of any business, focus should be placed on growing future cash flows and/or reducing the risk associated with receiving those cash flows.

These circumstances have many ramifications for business owners preparing to sell their companies. To translate theory into practice, there are several areas owners can address to improve value: >

1. Develop a business plan. Because future cash flows are often difficult for buyers to quantify, a good business plan may help suitors recognize the true potential of the business as well as prove comforting to them concerning the business risks. A good business plan will include an assessment of the market and a business strategy to take advantage of market opportunities.

2. Clean up books and improve management reports. Buyers often evaluate sellers' financial projections against historical financial information and use management reports to help understand the business. Often a buyer will have more confidence in a management team that has timely and accurate reporting on key performance indicators of the business. Additionally, during the due diligence process, the need for timely and accurate information exacerbates. Key accounting principles should be reviewed to make sure revenue recognition complies with generally accepted accounting principles, accruals are properly accounted for, stale inventory is carried at fair market value and adequate reserves are established for bad debts.

3. Quantify non-businesses expenses ("addbacks" or "normalization adjustments") and consider eliminating them from the entity altogether. Occasionally, private business owners do not accurately segregate expenses unrelated to the business for sale. Obviously, sellers will want to document non-recurring or non-related expenses for the buyer to support higher pro forma earnings and cash flows, and, thus, higher valuations. During a sale process, unprepared owners often scramble to try to document these expenses in vain. Proper documentation and segregation prior to sale may help eliminate heartaches later.

4. Convert excess equipment and non-business assets to cash. Potential buyers are interested in acquiring the underlying cash flow stream of the business, not generally non-essential businesses assets. If a business has excess assets, (those not currently required in business operations) or if personal property is owned by the business, it may make sense to transfer or otherwise monetize (through auction) these assets prior to a sale. Examples may include personal automobiles, raw land held for investment or surplus production equipment.

5. Focus on working capital efficiency. Many businesses require significant investments in working capital. Again, as potential buyers are interested in acquiring the underlying cash flow stream of the business, they are unlikely to pay owners for less than optimal working capital management. Aggressive attention to accounts receivable collections and appropriate credit policies can help convert assets to cash and reduce bad debts. Keen attention to inventory turnover can help reduce investment and perhaps minimize obsolescence down the road. Paying creditors along credit terms, as apposed to early, can potentially reduce investment as well.

6. Review all business contracts. If possible, it may make sense to extend certain key contracts to reduce risk for the buyer, including customer contracts, employment agreements, non-competes and supply contracts. Real estate leases also need to be reviewed, because buyers may or may not be interested in these locations. If the business occupies real estate owned personally by the shareholders, care should be taken to ensure proper leases are in place and that rents are at market value if the real estate is not included in a sale.

Notably, during preparation it is important to continue to operate the business as if it will be retained indefinitely by making important day-to-day decisions. If an investment is required to replace obsolete machinery or fill a management void, these investments should be made prior to sale. Likewise, if restructuring is necessary to reduce excess capacity or eliminate under-performing business units, action should not be postponed for the buyer. Moreover, sellers need to remember to pursue profitable sales and revenues, not just business for the sake of top-line growth alone. Buyers will focus on the bottom line and will not look at unprofitable sales favorably. Remember that in practice, businesses are valued based on their underlying cash flow generating ability, and not as a multiple of revenues without concern to profitability.

In conclusion, business owners can expedite the sale process, attract more interested parties and yield higher sale proceeds through proper preparation. The optimal time for preparation can range from 12 to 18 months, but significant results can be made in as little as four months. ■

Deal of the quarter

Grant Thornton Corporate Finance LLC recently acted as the exclusive financial advisor to Tell Tool Inc. on its sale to Platte River Ventures LLC.

Tell Tool Inc. is a leading manufacturer of intricately machined, critical jet engine and jet hydraulics components for the aerospace market. The business was acquired by Platte River Ventures LLC, a Denver-based private equity investment firm focused on small and middle-market industrial companies, in conjunction with management. Platte River Ventures LLC draws upon the significant operating expertise of its principals to serve as a value-added investor to its management partners.

"We are extremely excited to have partnered with an investor group that shares our vision of building a world-class, critical-machined parts business serving the aircraft industry," says Tell Tool President, Mark DiLorenzo.

Of the role Grant Thornton played in the acquisition Mark adds, "Ian Cookson, Corporate Finance LLC director, and the Corporate Finance group at Grant Thornton did a terrific job for us. They brought us a buyer and partner who is a tremendous fit and is well placed to help us build the business going forward. The transaction was an excellent outcome for outgoing shareholders, the business, management and employees. I am excited about our future and I am very grateful to Ian and the people at Grant Thornton for all their efforts."

"We were fortunate to generate significant interest from potential buyers of Tell Tool, particularly from the private equity community where there are many groups looking to consolidate fragmented industries," says Cookson who led the assignment. ■

Grant Thornton Corporate Finance news

April 7, 2006 - Grant Thornton Corporate Finance LLC recently advised Mr. Steven M. Luscinski and private equity investor Tulcan L.P. on their acquisition of Carter Controls Systems, a leading manufacturer of material handling equipment for high-volume mailers. Ian Cookson, director, led the transaction team.

April 13, 2006 - Grant Thornton Corporate Finance LLC advised Pierce Pacific Manufacturing Inc., a manufacturer of heavy equipment for timber processing and material handling, on its acquisition of the operating assets of Denharco Inc., a world leader in the supply of first quality forest harvesting equipment. The team was led by Stephen McGee, executive director.

April 27, 2006 - Grant Thornton Corporate Finance LLC recently acted as exclusive financial advisor to Tell Tool Inc., a precision aerospace components manufacturer, on its sale to Platte River Ventures LLC, a Denver-based private equity investor. Ian Cookson led the transaction team.

April 30, 2006 - Grant Thornton Corporate Finance LLC published a M&A industry report in the Plastics Compounding sector. To access any of our industry reports, please visit www.grantthornton.com/dealmaker.

May 8, 2006 - In an article titled "The (dollars and) cents of privacy," published in *Home Furnishings News*, Grant Thornton Corporate Finance LLC Directors Christopher Kampe and Ian Cookson are quoted on private equity backed going private transactions in the retail sector.

June 2006 - In an article titled "Keeping control — How to raise business capital with out losing control of your company," in the June 2006 edition of *Twin Cities Business*, Christopher Kampe is quoted on raising capital for privately held businesses.

June 6, 2006 - Christopher Kampe spoke on the subject of M&A to the Twin Cities chapter of Financial Executives International.

July 2006 - In an article titled "The big deals wheel again — The $30 billion takeover of HCA marks the rise of private-equity firms — and a new buyout wave," in *Time Magazine*, Christopher Kampe is quoted on leveraged buyouts in the retail sector.

Aug. 8, 2006 - Grant Thornton Corporate Finance LLC advised New Balance on its acquisition of Brine Inc., a recognized industry leader in soccer, lacrosse, field hockey and volleyball products, based in Milford, Mass. George Shaw, managing director, led the transaction team.

Aug. 8, 2006 - Grant Thornton Corporate Finance LLC is pleased to announce that Jonathan Cooper has joined the Boston office as a senior associate. Jon was previously with Duff & Phelps in Chicago, where he provided clients with business valuations, strategic options reviews, ESOP valuations and fairness opinions. Jon is a graduate of Washington University in St. Louis.

Aug. 30, 2006 - Grant Thornton Corporate Finance LLC published a M&A industry report in the Urban Retailing sector. To access any of our industry reports, please visit www.grantthornton.com/dealmaker.

About Grant Thornton Corporate Finance

Grant Thornton Corporate Finance provides boutique investment banking services to privately held middle-market businesses in the United States and around the world. As a recognized advisor on middle-market mergers and acquisitions, we offer a range of investment banking services including sell side advisory, buy side advisory, management buyouts, restructurings and capital raising. Grant Thornton LLP provides investment banking services through its wholly owned broker-dealer subsidiary Grant Thornton Corporate Finance LLC.