

Dealmaker

Providing business owners and managers
with M&A market insight

Grant Thornton 

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2003 Merger & Acquisition market shows signs of improvement

According to Mergerstat, 7,983 net merger & acquisition (M&A) transactions were announced in 2003, representing a nine percent increase over 2002, reversing a two-year downward trend. The number of transactions performed during 2003 was twice the long-term average of approximately 4,000 transactions per year. "From a long-term historical perspective, the United States continues to be in the midst of an active M&A cycle, which began in 1996," says George Shaw, managing director of Grant Thornton Corporate Finance.

2003 Middle-market M&A commentary

The most active middle-market M&A industry segments during 2003 were technology, services and finance, reflecting the changing makeup of the U.S. economy. Technology M&A was heavily concentrated in software, which in recent years has been the most active sub-segment, due in part to some significant advances in technology (e.g. Y2k, Internet, ERP etc.) and the constant pressure on software companies to innovate and achieve scale.

Perhaps more surprising is the prevalence of the finance segment in middle-market M&A, which has historically been more of a mega-deal sector. Two trends help to explain the sector's growing popularity. First, regional and community banks, seeking higher yielding assets and more fee income, have been actively acquiring non-bank insurance, asset management and specialty finance

businesses. Second, rapid consolidation is taking place in the property and casualty insurance agency business.

Following the stock market downturn that occurred in 2000, we witnessed a change in how transactions are structured: buyers stopped offering, and sellers stopped accepting stock as consideration.

Approximately 65 percent of middle-market transactions, as reported by Mergerstat, were all cash deals, while stock deals represented only 11 percent of transactions that disclosed price. Despite the recent rebound in the capital markets, greater acceptance of stock as an acquisition currency has yet to follow suit. >

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Deal of the quarter

New Balance Acquires Warrior Lacrosse

Rationale: Growth through access to new customer demographic

New Balance Athletic Shoe, Inc., the second largest athletic footwear company in the United States, last month purchased Warrior Lacrosse Inc., the premier manufacturer of lacrosse equipment. "At first blush, the transaction might seem out of step for New Balance", says Christopher Kampe, a director with Grant Thornton Corporate Finance, "which is best known for making high performance, footwear for individual sports, such as running and walking.

"However, the acquisition provides New Balance with an avenue to attract younger athletes to the New Balance brand, currently purchased largely by adult athletes."

"When you think about reaching the young demographic, team sports are the logical way in," reports Stephen McGee, also a director with Grant Thornton Corporate Finance. "The challenge to team sports, however, is that entry into basketball, football and baseball often requires expensive endorsements of professional athletes – a strategy historically avoided by New Balance. Lacrosse is not associated with well known celebrity athletes, but at the same time is one of the fastest growing team sports in America, perhaps making it the quintessential ticket."

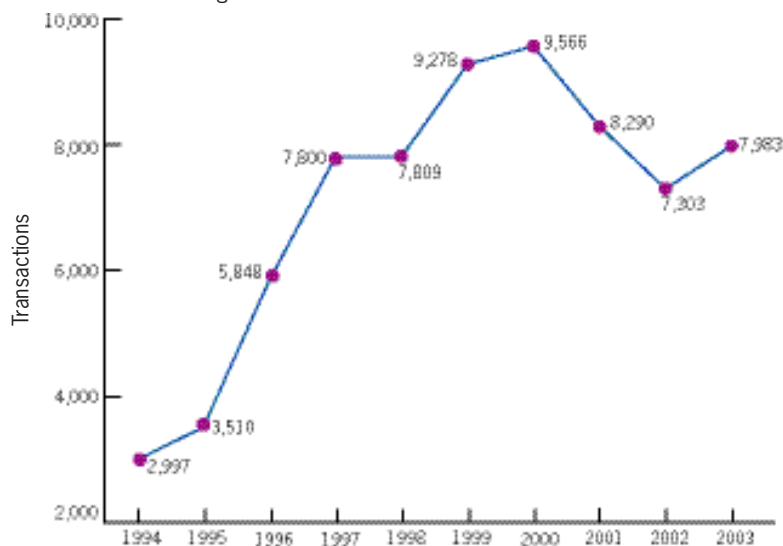
"As the next logical extension, one could see New Balance look at other high growth team sports, such as soccer, which also has an affluent, high performance demographic," says Kampe.

Merger discussions came out of a new strategic partnership, under which New Balance is producing a new line of co-branded Lacrosse shoes leveraging the Warrior brand. ■

One final observation is that leveraged buyout (LBO) valuations are edging up. A large part of the capital structure in an LBO is made up of debt financing, so as more debt financing becomes available, valuations can be driven up. In 2003, for transaction sizes under \$250 million, average LBO purchase price multiples climbed to 6.4 times EBITDA, from 5.8 times EBITDA in 2002. This may be an early sign that banks, which retracted rapidly from the acquisition finance market in 2000, are slowly beginning to come back (see chart below). ■

Net M&A transactions

Source: Mergerstat



Outlook for 2004

M&A activity is directly linked to availability of capital, both equity and debt. There were many positive indications in the capital markets in 2003 that could contribute to a strong 2004, including:

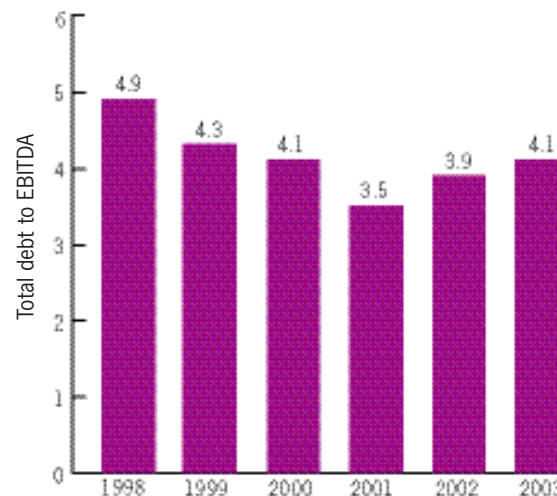
- Confidence in the equity markets was restored. After suffering setbacks from terrorist attacks, a recession and corporate scandals, the markets increased in 2003. The Dow Jones Industrial average finished the year up 25 percent, while the technology-heavy NASDAQ climbed 50 percent.
- Initial public offerings (IPOs) picked up at year end. There were 84 IPOs in 2003, down from 94 in 2002, but it was telling that 23 occurred within the last month of the calendar year. >

- Leveraged buyout debt multiples have increased, particularly on the large end of the spectrum. Average total debt to EBITDA on leveraged buyouts was 4.1 times in 2003, up from 3.9 times in 2002 and 3.5 times in 2001. Banks in general have been more aggressive in lending and some of these trends could trickle down to the middle market in 2004.
- Middle-market business owners have more confidence in the economy and their businesses, which should lead to an up-tick in M&A activity. According to the most recent Survey of Middle-Market Business Leaders, a national survey conducted by Grant Thornton of more than 300 U.S. business leaders and executives, 83 percent of respondents think the economy is going to improve in the next year, 93 percent are optimistic about the growth of their own business and 42 percent see M&A as a specific opportunity for growth.

“Based on activity we have seen in the last three months, more buyers are coming back to the market, valuations are creeping up and banks seem to be willing to lend more money to fund good deals,” says Shaw. ■

Leveraged buyouts – average debt multiples

Source: S&P PMD



Grant Thornton Corporate Finance: Who we are

In 2003, Grant Thornton was credited with 109 M&A transactions worldwide, placing the firm 19th in the annual M&A league tables produced by Thomson Financial. This is the third year in succession that Grant Thornton has placed in the Top 20, ranking 18th in both 2001 and 2002. Grant Thornton has approximately 1,000 corporate finance professionals around the world.

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