Vol. 1, No. 2 **Summer 2004**

Dealmaker

Providing business owners and managers
with M&A market insight

Grant Thornton

In this issue

The leveraged recap: An often overlooked tool to achieve shareholder liquidity

In advising Grant Thornton clients, we talk with scores of business owners to learn about their objectives and discuss their strategic alternatives. Many have spent decades building a business and now seek for the first time to reap some of the financial fruits of their labor. Often, middle-market business owners have the bulk of their personal net worth tied up in one asset - the company. Other times, we meet groups of shareholders that have very different personal objectives, with some wanting to reinvest to grow the business and others wanting to exit and sell their shares.

A leveraged recapitalization can solve many of these issues, including:

- transferring a business from one generation to the next and funding tax liabilities,
- achieving portfolio diversification, when the majority of a shareholders' net worth is tied up in the business,
- attracting growth capital,
- solving differing shareholder objectives, allowing the buyout of select shareholders; and
- achieving shareholder liquidity, while still preserving the family business and protecting the jobs of employees.

How does a leveraged recap work?

In a leveraged recap, a business attracts new capital to provide significant liquidity to some or all of the existing shareholders. New capital can be in the form of debt, or a combination of both debt and equity or other related financial instruments such as mezzanine. In general, these transactions allow shareholders to:

- take substantial cash off the table,
- retain significant ownership,
- continue to run/manage the business; and
- obtain new growth capital.

In most cases, a leveraged recap involves a private equity group or PEG. The PEG uses a combination of cash (from its investment fund) and bank debt to finance the acquisition. The business owner retains a meaningful equity position in the company (typically 20 to 40 percent), which is intended to provide a second liquidity event or "second bite of the apple" in the future. Finally, the PEG will likely provide some incentives to members of the management team, allowing key employees to invest >

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For additional information on issues discussed in the newsletter, consult your Grant Thornton client-service partner or **George Shaw**, George.Shaw@gt.com.

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Deal of the quarter: Similar visions lead to business combination for market leaders

Macrovision® Corporation (NASDAQ: MVSN) acquires InstallShield® Software Corporation
Rationale: Extension of product offering and access to installed base

On June 16, 2004, Macrovision® Corporation (NASDAQ: MVSN) announced that is had signed a definitive agreement to acquire the assets and operations of privately-held InstallShield® Software Corporation for $76 million in a cash transaction. An additional payment of as much as $20 million is contingent upon post-acquisition performance.

As the de facto standard in installation tools, InstallShield's vision is to make software easily portable and consumable. Similarly, as the de facto standard in software licensing, Macrovision seeks to simplify and enhance the distribution process to make technology more accessible to everyone. The combined entity will be able to provide comprehensive solutions for packaging, pricing, protecting, installing, maintaining, distributing, conflict-solving and optimized-licensing of software.

Key strategic benefits Macrovision identified in the transaction include:

- Expansion of its product portfolio in the software value management category.
- Access to InstallShield's large installed based of customers, currently using customized solutions for digital rights management.
- Leverage from InstallShield's marketing leading position and brand equity.
- Expansion of sales teams, distribution partners and development resources.

Bottom line
The acquisition of InstallShield by Macrovision should help software publishers and enterprises maximize the value of their software throughout the lifecycle from development through end-user deployment, administration and updating, and development of Macrovision as the leader in software value management tools. ■

The leveraged recap; continued

alongside them, and perhaps, creating a stock option plan. Clearly there are some key attributes a company must have to make the leveraged recap attractive for the PEG who, by the way, will be looking to generate an internal rate of return (IRR) in excess of 25 percent on the investment. They include:

- a strong management team,
- a history of growth and profitability,
- realistic growth opportunities,
- a defensible market position,
- predictable cash flows (to support leverage),
- an un-levered balance sheet; and
- a viable exit strategy - sale to strategic buyer or initial public offering or another recap.

Valuation for leveraged recaps are heavily influenced by the availability of debt financing, the future growth potential of the company, and the likely strategy for exiting the investment five to seven years down the road. In 2003, the average multiple of EBITDA paid in middle-market (< $100M transaction value) leveraged buyouts was 6.3x EBITDA of which 3.8x was financed with debt instruments (senior debt, mezzanine etc.)

One thing to bear in mind, if the PEG is making a 25 percent IRR on its investment, so too is the business owner on his or her retained stake. This second bite of the apple, combined with the cash taken off the table at the time of the recap, can provide an overall value to the business owner far in excess of what might have been achieved had he or she sold the company outright to a strategic competitor. Furthermore, the owner has provided for continuity of the business, security for the employees, a significant ownership opportunity for the management, and at the same time, watched the company flourish and reach its full potential.

Leveraged recaps may not be suited to every situation, but if the circumstances are right, they can provide a viable, and valuable, alternative to business owners wrestling with the decision to sell their company. ■

Cross-border transactions: It's a small world after all

Inevitably, cross-border transactions are something that can't be ignored. In 2003, cross-border deals accounted for 26 percent of worldwide M&A activity. Year-to-date (June) cross-border transactions – closed or pending – stand at $222 billion in value and close to 4,000 in number. If this pace continues through the second half of the year, it will be the third year in succession that cross-border activity has increased.

With this in mind, Grant Thornton Corporate Finance recently held its international conference in Amsterdam. The conference brought together more than 60 delegates from 23 countries to discuss some of the significant trends in cross-border transactions.

Worldwide chairman of Grant Thornton Corporate Finance, David Spence, said, "Grant Thornton's international corporate finance capability is critical to serving middle-market clients contemplating M&A transactions as more and more companies look to overseas markets for their acquisition targets."

Take for example, the April 2004 sale of Grand Virtual, Inc., a U.S.-based software developer, to GigaMedia Limited (NASDAQ: GIGM), headquartered in Taiwan. Stephen McGee, a director in Grant Thornton Corporate Finance's Boston office, led an international transaction team, comprised of Grant Thornton professionals from London, Paris, Hamburg and Hong Kong. Through effective coordination of its worldwide resources, the deal team was able to identify GigaMedia, a Taiwanese-based company, as well as generating other offers from companies in the United States, United Kingdom, Germany and Australia.

"The Grand Virtual experience wasn't unusual, we've always seen a tremendous level of cross-border interest on our deals," comments McGee.

"Though political uncertainty may lead some companies to reconsider their overseas investment plans, increasing competitive pressures and the globalization of local economies will continue to be major driving forces for cross-border M&A activities across all regions," says Ian Smith, a director in Grant Thornton Corporate Finance's Hong Kong office. "Our recent role as lead advisors to a Taiwan-headquartered jewelry manufacturer on the acquisition of Majorica SA, Spain's most prominent domestic jewelry brand, is a case-in-point."

Majorica was a venerable European brand that had fallen on hard times due to a dramatic rise in salaries and social welfare benefits in Spain. At the same time, political considerations and firmly entrenched management beliefs meant that the company maintained 100 percent of its production in Spain, despite this being dramatically more expensive than outsourcing even portions of their production to Asian OEM manufacturers. “Our client acquired control of the company and immediately installed new senior management, while moving some production to its factories in Thailand and China. Sales are already improving, margins have expanded and the company appears to have reestablished a foundation for future growth,” comments Smith.

Why think cross-border?

Why are companies considering cross-border acquisitions? Highlighted below are some of the key reasons:

- Companies are encountering pressure to compete with their global competitors.
- Companies faced with sluggish domestic demands are looking to international markets for growth.
- Companies are motivated to acquire more competitive foreign technology that can be transferred to their domestic market place in anticipation of meeting the increased competition.
- Companies are seeking a fast-track route to entering into foreign markets by acquiring established foreign operations. ■

Other GTCF news

Rebecca Tarby is a senior associate in the Boston office.

New Hires

Grant Thornton Corporate Finance is pleased to announce that Rebecca Tarby has joined the corporate finance team as a senior associate. Most recently, Rebecca worked for Fleet M&A Advisors, the investment banking branch of Fleet Financial Group, where she specialized in middle market transactions.

"We're very excited to have Rebecca as part of the team," commented George Shaw, managing director of Grant Thornton Corporate Finance. "She is a seasoned M&A associate, experienced in all aspects of sale, divestiture and acquisition transactions, including valuation, research and company marketing."

More cross-border deal news

Grant Thornton Corporate Finance is also pleased to announce the sale of Avellino Technologies Ltd. to Harte-Hanks, Inc. (NYSE: HHS). Avellino is a leading provider of data profiling technology. Grant Thornton's London-based Corporate Finance team led the transaction with support from the Boston office corporate finance team.

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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- Merger and acquisition market updates
- Sector specific valuation multiples
- Leveraged loan multiples
- Private equity/venture capital markets
- Debt financing market updates

For more information on these topics or any of the topics covered in this newsletter, please send an e-mail to M&Aresearch@gt.com.

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