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Dealmaker

Providing business owners and managers
with M&A market insight

Grant Thornton

In this issue

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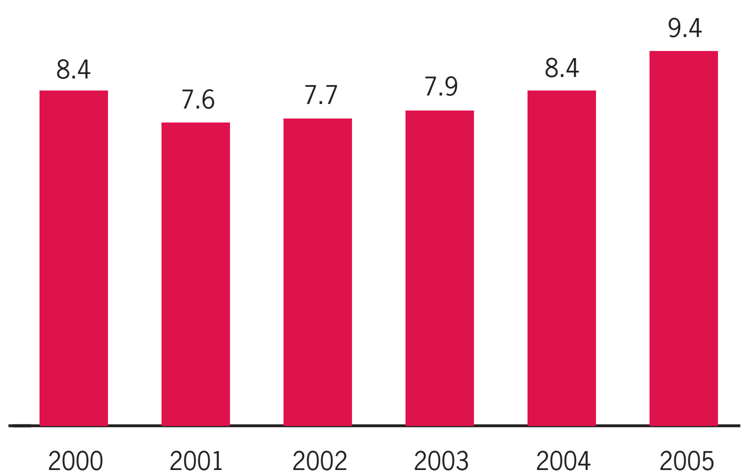
Valuation: New study finds published statistics often misleading

Middle-market business valuations have reached their highest levels in years according to a new valuation study conducted by Grant Thornton Corporate Finance LLC (GTCF). Based on the proprietary study, the median enterprise value (EV) to EBITDA multiple on middle-market transactions closed or announced during 2005 was 9.4x, representing a 16 percent increase over the median multiple in 2004. This represents the forth consecutive year that valuation multiples have increased.

Median EV/EBITDA multiples
transactions valued between $10MM and $200MM



However, broad market valuation statistics are misleading as multiples can and do vary widely based on a host of underlying factors including: growth prospects, cyclicality, competitive market position and barriers to entry, just to name a few. While the impact of these factors is often difficult to quantify, the GTCF study identified two variables that commonly influenced valuation - industry segment and size. (continued on page 2) >

Industry specific data provides a better comparison

Valuation multiples can differ dramatically by industry. Take for example, the consumer segment, where median EV/EBITDA multiples have consistently been in the 7.0x to 8.0x range each year since 2000. Now contrast this with the information technology sector, where median EV/EBITDA multiples have ranged from 10.0x to 12.0x.

We believe industry segment is relevant because it often captures, albeit clumsily, certain key valuation drivers such as growth prospects, cyclicality and risk. So then, it should be of no surprise that faster growing industry segments (such as information technology or healthcare) will sell at higher valuations relative to slower growth segments (such as consumer or industrials). Additionally, sectors such as materials, where products are largely undifferentiated and pricing is determined by supply and demand, will have a discount to consumer sector transactions, where companies often enjoy real or perceived product differentiation and brand loyalty.

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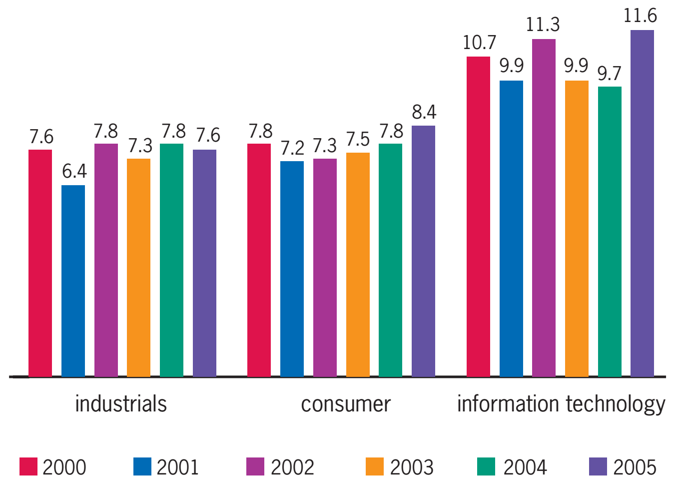
Median EV/EBITDA multiples
transactions valued between $10MM and $200MM

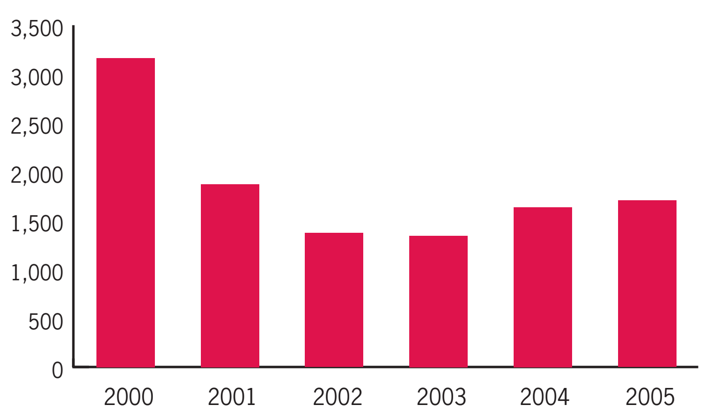


Software industry continues to consolidate

by Mark Shifrin, Grant Thornton Corporate Finance associate

In 2005, merger and acquisition ("M&A") activity in the software industry remained strong, serving once again as the most active M&A sector and representing 16 percent of the 10,716 deals closed in the United States throughout the year. This level of activity was in large part driven by the overall health of the economy, the availability of capital and a number of software industry specific trends that aligned, making 2005 one of the most active M&A years since the 2000 "bubble."

US software M&A activity measured by number of transactions



Source: Mergerstat

Industry trends

One of the principal drivers of this rise in software M&A activity is the corporate information technology (IT) managers' desire to get a broader suite of offerings from fewer vendors. During the late 1990s and early 2000s there was a dramatic increase in the number of new, often niche, software products brought to market. Many of these small to mid-size software providers offered narrow point solutions with hundreds of features. Many large organizations, governments included, found themselves dealing with dozens of software vendors which proved difficult and expensive to maintain, and more often than not, these different software products did not work well together. IT managers now prefer to deal with fewer strategic vendors who can offer a richer portfolio of products, as well as ensure that those products work well together from the start. As a result, software providers are consolidating as customers demand reduced complexity and lower costs.

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Valuation...(continued)

Additionally, the GTCF study found that the volatility in valuation multiples was much lower for mature, established industry sectors such as industrials, especially when compared to other sectors like information technology which on the surface were more random. Importantly, the market values information technology companies less on past performance and more on future expectations.

Size matters in valuation

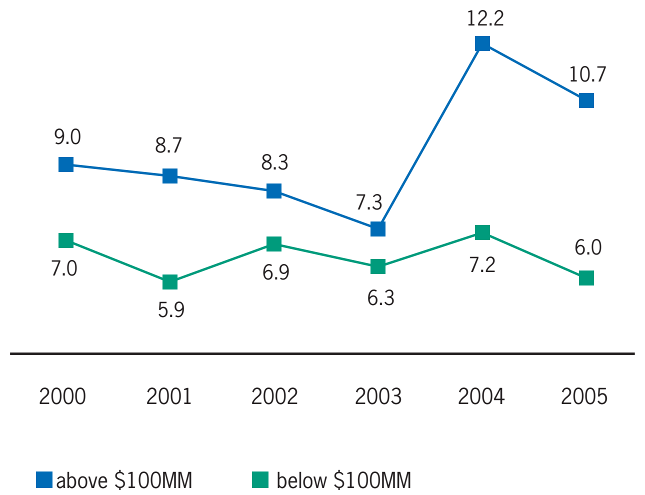
Based on the data, larger companies and bigger deals generally sold at higher relative valuation multiples than smaller ones. For example, the median EV to EBITDA multiple for transactions valued between $100 and $200 million was 10.6x in 2005, while the median EV to EBITDA for transactions valued between $10 and $100 million was only 8.7 times. While the size of the valuation gap has widened and narrowed over the years, this trend has held up reasonably well over time.

Comments Christopher Kampe, Grant Thornton Corporate Finance director: "Theory holds that larger companies tend to have stronger, more defensible businesses than smaller firms, thus supporting higher relative valuations because of lower levels of risk. In practice, many buyers believe that smaller transactions add less, but at the same time, will consume equal (if not greater) resources."

"In our experience, especially in the consumer and industrial segments, we have witnessed significantly more interest in companies with EBITDA in excess of $5 million than those with less than $5 million, and still even more interest in companies with EBITDA in excess of $10 million."

Notably, the impact of size was much more pronounced in the industrial sector, where economies of scale are important and because significant capital investment can create barriers to entry. For example, the median EV to EBITDA multiple for industrial transactions valued more than $100 million was 10.7x in 2005, while the median EV to EBITDA for transactions valued less than $100 million was only 6.0x.

Median EV/EBITDA multiples for the Industrial Segment



Interestingly, in the information technology sector, size was not observed to be a factor in valuation at all. We believe that many information technology transactions are driven by the acquisition of knowledge - not tangible assets or historical profits. Many established technology companies rely on mergers & acquisitions as a form of outsourced research & development.

Concluding thoughts

Despite the fact that published generic multiples are often misapplied, there is no debate that valuation multiples across most industry segments are higher than they've been in years. According to Kampe, "today's high valuations are being driven by intense competition for deals among both strategic and financial buyers. This coupled with the abundance of capital available today to finance acquisitions has contributed to an environment that can only be called a seller's market."

For more information please contact Christopher Kampe, director, at 617.848.4984 or Christopher.kampe@gt.com.

Software industry continues to consolidate (continued)

The demand for reduced complexity is also driven by the stricter financial constraints which have been placed on IT budgets. As overall IT spending grows at a relatively slow rate of 2 to 3 percent per year, IT providers, and especially software providers, cannot assume they will grow organically by 20 percent per year. With this in mind, software providers strive to make strategic acquisitions that will ultimately help them capture a larger portion of the overall corporate IT budget.

Strategic acquirers

At the same time, some of the larger well-known IT companies have benefited from improved profitability, which has translated into significant cash war chests. Currently, Microsoft, Cisco, IBM, EMC and Oracle combined have more than $63 billion in cash on their balance sheets available for acquisitions. Many of these larger players have shown they are ready to step back into the M&A market after periods of relative inactivity. For example, IBM acquired 16 companies during 2005, compared to four in 2003.

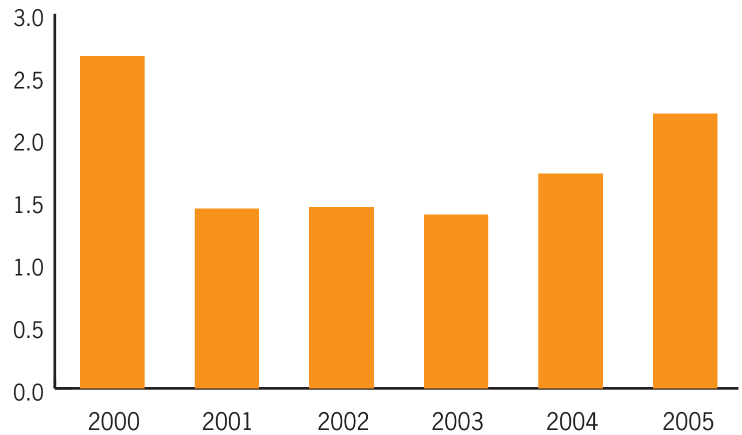
On the sell side, an increasing number of small to mid-size software companies are considering their exit strategies as it becomes progressively more difficult for companies with revenues less than $100 million to grow and make money. According to one industry commentator: "Small software vendors are facing a difficult situation with widespread commoditization of products threatening them from below and larger vendors invading their space from above."

These are signs that the software industry is maturing. While there are bright spots of growth (compliance software, open source software, security software, virus protection and anti-spam software), some sectors such as enterprise resource planning (ERP) and customer relationship management (CRM) have matured and largely leveled off. Take the ERP software market for example. This sector has transformed from 400 ERP companies 10 years ago to approximately 20 players today. And, while many companies remain profitable (especially large, global software providers), there is an undeniable glut of companies chasing a revenue pool that has ceased to expand quickly enough to support them all.

Valuation multiples

Increased M&A activity typically leads to increases in valuation multiples, at least for a period of time. As the chart below shows, the median price paid for mid-cap software companies increased to 2.2 times sales in 2005 - the first time since 2000 that revenue multiples have been in excess of 2 times.

US software - M&A revenue multiples



Source: Capital IQ

However, it must be noted that even though the median sales multiple is 2.2x, there are significant variations depending on the specific sector in which a company operates. This is evidenced by the multiples of publicly traded software companies. A quick analysis of enterprise to sales multiples reveals that publicly traded companies providing software security products and Internet infrastructure are trading at a median multiple of 5.2 times trailing twelve month (TTM) sales, while some of the smaller ERP and CRM companies are trading at a median of only 1.7x TTM sales.

With corporate spending and deal making on the rise, the short-term outlook for M&A activity in the software industry remains positive. The continuous cycle of innovation which leads to growth in new products and services, followed by maturation and consolidation, will persist as long as low barriers to entry continue to provide start-up software companies with a reasonable chance of success, allowing them to develop unique solutions to address the information technology challenges of today and the future. Thus, the pool of small to mid-size software companies looking for an exit strategy will remain plentiful as long as the economy stays on track, and both consumers and business purchasers continue to accept and adopt new technologies.

For more information regarding technology industry M&A, please contact Stephen McGee, director with Grant Thornton Corporate Finance, at Stephen.McGee@gt.com or 617.848.4988. ■

Deal of the quarter

Grant Thornton Corporate Finance LLC recently advised on the sale of Sakson & Taylor, a leading content and design development firm, to Aquent, a global professional services provider of staffing, consulting and outsourcing solutions. The transaction brought together two businesses with tremendous strategic fit and remarkably similar cultures. It also provided the companies' respective clients with access to a broader range of services.

According to John Chuang, Aquent chief executive officer, "By combining the services and the customer bases of both organizations, we can now provide even greater proficiency in content design and development staffing projects and managed services. Further, Sakson & Taylor's thought leadership in this area, combined with their strong relationships with leading technology companies, makes them a great addition for Aquent's current network of technology customers."

"The culture fit between the two companies is ideal," added Sakson & Taylor founder Donna Sakson. "Both are entrepreneurial in practice and philosophy, are privately held and have been industry leaders for more than twenty years. Equally important is that both companies focus on caring for employees while providing clients with highly innovative, technology rich solutions."

"The transaction was really a win, win," said Stephen McGee, director with Grant Thornton Corporate Finance LLC, who led the transaction. "The sale provided the principal shareholder of Sakson & Taylor with the opportunity to gain liquidity, while at the same time providing the management team with access to greater resources and a new opportunity to grow the business within a larger organization."

Cheryl King Berry, Sakson & Taylor's chief operating officer, will continue to be responsible for the growth and success of the business. "Aquent and Sakson & Taylor bring together the best combination of talent, technology and resources for our clients," said Berry. "The reason we have been so successful in the niche of content design and development is that we realize the value we offer-we help our clients understand the importance of content in realizing their business goals. Now we have more capabilities to help clients succeed in this area."

About Aquent

Aquent is a global professional services firm that delivers staffing, consulting, and outsourcing solutions for marketing and creative services, IT, and healthcare. Through a network of more than seventy offices in sixteen countries, Aquent matches contract and full-time professionals with client companies worldwide. The company is headquartered in Boston, MA.

About Sakson & Taylor

Sakson & Taylor, founded in 1985 by Donna Sakson, is a leading content design and development firm, offering services for content development, learning, Web solutions, and knowledge management. The company provides global and scalable content solutions focused on creating competitive advantage for our customers. The company is headquartered in Seattle, WA. ■

GTCF news

Grant Thornton will once again serve as the Platinum sponsor of the Association for Corporate Growth's (ACG) Boston Growth Conference on June 13 and 14. This is one of the East Coast's largest merger & acquisition conferences with more than 1,000 attendees from private equity firms and investment banks, along with middle-market company chief executive officers and business owners. This year's keynote speaker is Bo Burlingham, editor at large of *Inc. Magazine* and author of *Small Giants – Companies that Choose to Be Great Instead of Big*. For more information or to register online visit www.acgboston.org.

In December, Grant Thornton Corporate Finance published an M&A industry report on the aerospace components sector. In addition, issues regarding the plastics, speciality retail and software industries are scheduled for release this spring. To access all 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.