

Dealmaker

Providing business owners and managers
with M&A market insight

Grant Thornton 

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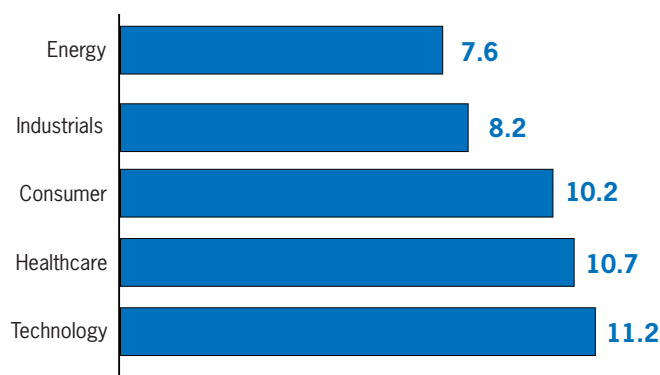
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Results of GTCF 2005 middle-market valuation study

Strategic buyers have returned to the market and so it seems have strategic valuations. Based on a Grant Thornton study of 68 middle-market strategic transactions announced or closed during the first nine months of 2005, the median enterprise value to EBITDA multiple paid was 10.5 times. The Grant Thornton Corporate Finance study focused on strategic transactions with enterprise value between \$10.0 million and \$200 million announced in the first nine months of 2005. As one would expect, mature industry segments such as energy and industrial transactions commanded lower multiples with a median of approximately 8.0 times EBITDA, while higher growth sectors such as healthcare and information technology exhibited more robust valuations (around 11.0 times EBITDA). Size of course, continued to matter, with smaller companies often fetching lower relative valuations than that of larger companies. Take for example, industrial sector transactions where deals less than \$100 million had a median EBITDA multiple of 6.6 times, versus industrial transactions between \$100 million and \$200 million, which had a median multiple of 10.6 times EBITDA. ■

Midmarket Transaction EBITDA Multiples (YTD 2005)



Year-to-date M&A market recap

So far in 2005, transaction volume has remained buoyant. According to MergerStat®, 7,656 transactions were announced in the United States in the first nine months of 2005 – a number roughly equal to the comparable period in 2004.

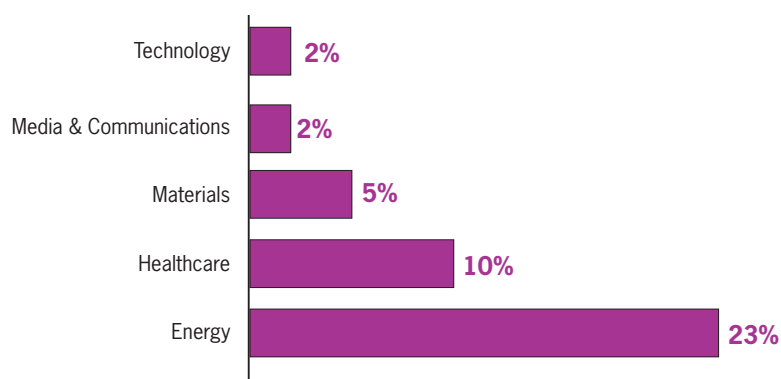
Within broad industry segments, however, some industry sectors, such as energy and healthcare, experienced more pronounced growth in M&A, with each sector showing double digit increases in deal volume. While activity in

industrials as a whole was relatively stable, there was significant upward movement within certain sub-segments, such as plastics & rubber, aerospace & defense and fabricated metal products, each growing by 50 percent or more. Other sectors, such as utilities, consumer and financials saw transaction volume begin to slow in 2005. ■

Target Industry Group	YTD 2005 Deal count	YTD 2004 Deal Count
Industrial	2,121	2,126
Technology	1,529	1,504
Consumer	1,093	1,185
Financials	1,008	1,090
Media & Communications	694	678
Healthcare	477	434
Materials	438	418
Energy	171	139
Utilities	125	139
Totals	7,656	7,713

The 2005 deal count is for the nine-month period ended Sept. 30, 2005. The 2004 deal count is for the nine-month period ended Sept. 30, 2004. Source: MergerStat®, Grant Thornton Corporate Finance.

Fastest growing industry sectors



Graph measured by the percentage increase in the number of transactions announced in the nine month period ended Sept. 30, 2005.

The return of the roll-up

By Christopher Kampe, Grant Thornton Corporate Finance Director

Throughout the 1990s, the “roll-up” swept the M&A market, leading to the consolidation of a number of mom and pop industry segments. A myriad of relatively small transactions took place in segments such as funeral homes, bus/cab companies, HVAC contractors, dental practices, staffing, leasing companies, metal recyclers and flower wholesalers.

The roll-up is a strategy whereby an entity rapidly acquires a series of small companies in like businesses and then combines them to capture a dominant market position. Ideal roll-up choices are in fragmented, but mature industries, comprised of numerous undervalued small companies, where there are few (if any) national players and no principal market leader.

If done right, roll-ups can acquire competitive advantage by achieving critical mass, exploiting operating efficiencies, cutting costs, attracting superior management, building brand awareness, reducing risk and lowering the cost of capital. However, many 1990s consolidators paid too much for acquisitions, relied on excessive amounts of debt and failed to properly integrate the targets. As a result, only a fraction of well-known 1990s roll-ups successfully survived the recession and subsequent tightening of capital markets that followed.

History repeats itself

While many thought the roll-up's time had passed, it seems that roll-up consolidators still exist at least in a few segments, namely auto parts distribution, beauty schools/hair salons, convenience stores and insurance agencies. Today's roll-ups, however, are being executed on much sounder footings.

Acquirers are using less debt, paying more conservative prices, and are more cautious – spending more time on due diligence and post acquisition integration.

Take for example, Alimentation Couche Tard, which is consolidating the highly-fragmented mom and pop convenience store segment in North America. This Canadian-based company has announced seven relatively small acquisitions of convenience store chains in the U.S. since the beginning of 2005. Yet, perhaps different from the roll-ups of the past, the company is very disciplined in its evaluation of acquisitions with both strong strategic fit and reasonable valuation price as criteria.

The company analyzes acquisitions based on its ability to improve the targets profitability by leverage existing cost infrastructure, exploiting purchasing power, bringing in better systems and by better category management. Couche Tard also employs a fairly conservative capital structure relative to the roll-ups of the past, preferring to use sale/leasebacks of real property to assist in financing deals.

Roll-ups can clearly create a market for relatively small companies where previously there was none. In the past, the danger to the seller, however, was that many buyers were unhealthy and used stock as a meaningful part of purchase price. Today's roll-up acquirers, as a whole, are more willing to pay for acquisitions in cash and are much healthier.

For small to mid-sized firms operating in an industry segment that is being consolidated through a roll-up, it may well be time to consider a sale. If multiple consolidators are actively in the market acquiring companies at the same time, valuations can be particularly strong. ■

Examples of roll-up consolidators in 1998 and today

1998			
Roll-up Acquirer	Segment	Debt/EBITDA	Deals announced in 1998
Metals USA	Metal fabrication	4.5x	21
Pal Ex	Speciality packaging	5.0x	8
USA Floral Products	Floral distributor	5.5x	23
Service Corp.	Funeral homes	4.7x	5
Coach USA	Bus services	3.9x	6

2005			
Roll-up Acquirer	Segment	Debt/EBITDA	Deals announced in YTD 2005
Uni-Select Inc.	Auto parts distribution	0.9x	6
Regis Corp.	Hair salons/ cosmotology schools	2.2x	7
USI Holdings	Employee benefits/ insurance agencies	2.7x	8
Brown & Brown	P&C/insurance agencies	0.9x	12
Alimentation Couche-tard, Inc.	Convenience stores	1.5x	7

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Content for *Dealmaker* is produced by Stephen McGee and Christopher Kampe, directors with Grant Thornton Corporate Finance. For more information on any of the topics covered in this newsletter, please send an e-mail to Stephen.McGee@gt.com or Christopher.kampe@gt.com.

Deal of the quarter

In mid-September, Sumitomo Corp. announced an agreement to acquire TBC Corp., the largest independent tire dealer in the nation, with 1,175 company-owned and franchise outlets throughout the United States, as well as an enormous wholesale business, operating stores under the Tire Kingdom, National Tire & Battery and Big O Tires banners.

Japanese conglomerate Sumitomo is already in the tire business as manufacturer of both Sumitomo brand and private brand tires. In addition, Sumitomo also serves as one of the largest distributors of private-brand tires in the United States through its subsidiary Treadways Corporation. However, the acquisition of TBC will enable Sumitomo to become the largest seller of replacement tires in the United States, with reportedly 10 percent of the replacement market.

“This kind of vertical integration is not new to the industry,” says Christopher Kampe, director of Grant Thornton Corporate Finance. “Bridgestone/Firestone entered tire retail in 2001 through its acquisition of Morgan Tire & Auto, which operates stores under the Tires Plus banner.”

Also of note, but not driven by the same strategic rationale, Kampe adds that Monro Muffler Brake, has been expanding into tire retail. “Monro bought three tire retail chains in the last two years,” says Kampe.

According to Joe Tomarchio, Monro's tire operations divisional vice president and chief operating officer, Monro is actively seeking tire retail acquisitions in existing and contiguous markets where it can leverage advertising and management.

Mr. Tomarchio reports, “Expansion into the tire sector was a natural progression from our original brake and exhaust business.”

Unlike the brake and exhaust sector which has been consolidated, “the tire business offers numerous acquisition opportunities of small chains,” reports Tomarchio. “We at Monro are also in the market to acquire larger chains as shown by our recently announced transaction with the 101-store Strauss Discount Auto chain.”

Despite several transactions, most tire specialty retailers in the United States remain relatively small family-owned chains. However, some believe that that the TBC transaction could accelerate industry-wide consolidation in the near future. ■

GTCF news

In October, Grant Thornton Corporate Finance advised Levtran Enterprises, Inc., a leading urban retailer, on its sale to private equity investor Bruckmann, Rosser, Sherrill & Co. Levtran, d/b/a DTLR and Downtown Locker Room, operates more than forty stores selling urban apparel, footwear and music in seven markets. George Shaw and Christopher Kampe in the Boston office of Grant Thornton Corporate Finance led the transaction team.

Kampe was also quoted in the Sept. 26 issue of *Factset Flashwire Weekly*, an M&A publication published by Factset Mergerstat. In the article titled, “Valuations Plateau, Strategics Return,” Kampe discusses M&A activity in the sporting goods sector.

During the month of October, Grant Thornton Corporate Finance published three M&A industry reports in the Convenience Store, Automotive Aftermarket Parts and Sporting Goods sectors. To access these reports, please visit www.GrantThornton.com/Dealmaker.

On Sept. 22, 2005, Grant Thornton was a sponsor of The President's Forum of Boston, an annual event providing business leaders an opportunity to listen to executive speakers, attend workshops and network in a peer-to-peer environment. Grant Thornton directors Christopher Kampe and Stephen McGee moderated panels on valuation and mergers & acquisitions.

Grant Thornton Corporate Finance is pleased to announce that Mark Shifrin has joined the Boston-based corporate finance team as an associate. Mark joins GTCF from ZweigWhite, where he provided clients with business valuations and fairness opinions. Prior, Mark had served as an equity research analyst for Sanford C. Bernstein in New York. Mark has specialized knowledge in the technology and service industry sectors and received his MBA in finance from Babson College.

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.