

Dealmaker

Providing business owners and managers
with M&A market insight

Grant Thornton 

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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 Grant Thornton Corporate Finance LLC

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2004 wrap up: M&A market finally heats up

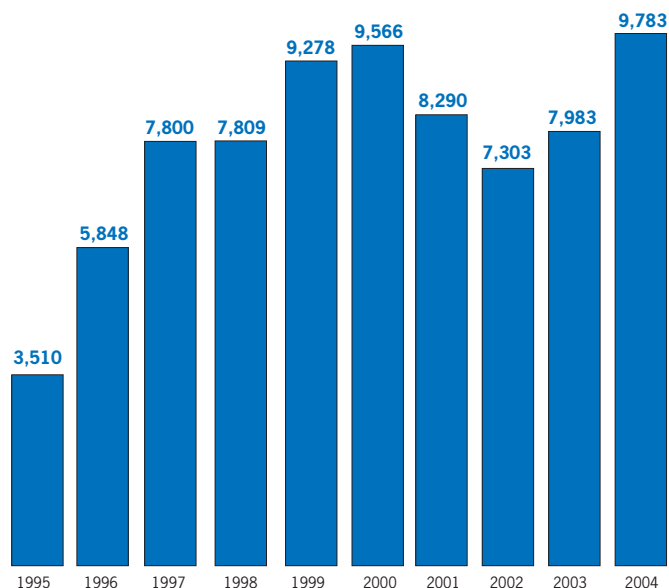
According to Mergerstat, 9,783 net merger & acquisition (M&A) transactions were announced in 2004, representing a 23 percent increase over 2003 and the highest recorded activity since the 2000 peak.

“The sheer number of deals reported in 2004 is proof positive that the M&A market has rebounded,” says George Shaw, managing director of Grant Thornton Corporate Finance LLC. “In 2004, activity was spurred by further loosening in credit markets, the return of the strategic acquirer, higher valuations and favorable interest rates.

“We have also seen heightened cross-border activity, with foreign interest in U.S. companies coming from both the old standbys of Canada, the United Kingdom, Germany and France, as well as the relative newcomers of Taiwan and China.”

Of the nine broad industry sectors tracked by Grant Thornton Corporate Finance, four segments made up nearly 80 percent of total M&A volume in 2004. These segments were industrial (2,757 deals announced), technology (1,946 deals), consumer (1,502 deals) and financial (1,368 deals). >

Net M&A Announcements source: Mergerstat



2004 wrap up: M&A market finally heats up

(continued from page 1)

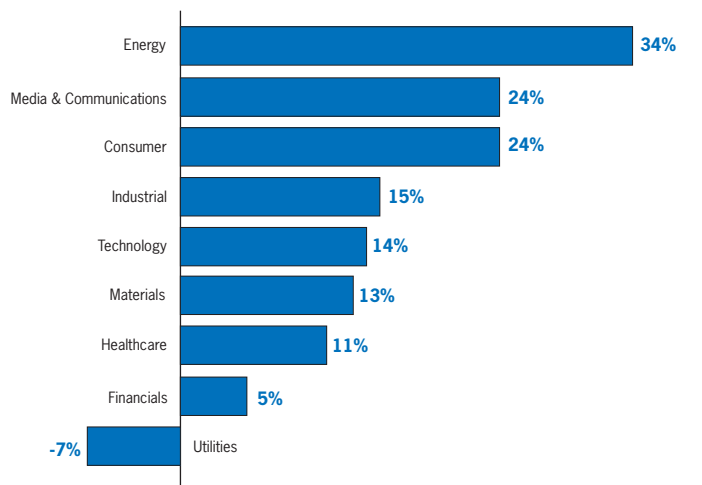
Hot industry sectors

However, not all sectors experienced equal growth in 2004. Leading industries included energy and energy services (+34%), media and communications (+24%) and consumer (+24%).

“The consumer segment remains one of the most sought after by both strategic acquirers and private equity investors alike,” says Christopher Kampe, director at Grant Thornton Corporate Finance LLC. “Within the broad consumer category, segments experiencing the highest growth in M&A activity were leisure and entertainment, textiles and apparel and agriculture.”

Industry sectors lagging overall M&A growth included: utilities (-7%), healthcare (+11%), and despite its large volume, financials (+5%).

M&A activity growth by sector



The year ahead

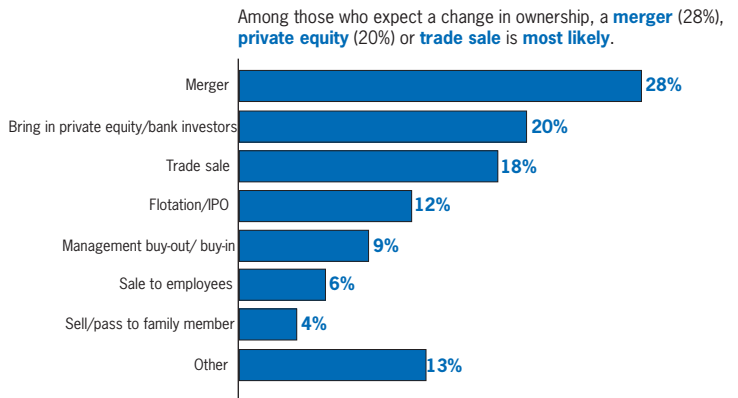
By most accounts, 2005 promises to be a banner year for mid-cap mergers and acquisitions. Several market factors have aligned that should bring more buyers and more sellers into the M&A market during 2005: interest rates are remaining low, capital markets are healthy, business profits are on the upswing, strategic acquirers have returned to the market, and valuation multiples have markedly improved from earlier levels.

Additionally, many private equity investments made during the most recent market peak (1998 through 2000) have now reached maturity and are likely to be sold over the next two years. Finally, as the baby boomer generation begins to retire

over the next ten years, many family-owned businesses will be sold, rather than past on to the next generation.

Based on Grant Thornton’s recent Survey of U.S. Business Leaders, our proprietary market research based on interviews of 300 business executives, 30 percent of U.S. business leaders interviewed expect their companies to change ownership within the next ten years, with nearly a quarter of that figure anticipate the switch will come within two years. ■

Anticipate a change in ownership



Source: Grant Thornton’s Survey of U.S. Business Leaders



For more information on anticipated ownership changes, checkout Grant Thornton’s survey of U.S. Business Leaders.

To receive a complimentary copy of the survey report, visit www.grantthornton.com/blcsurvey

How to value a company: Part II

By Rebecca Tarby, Grant Thornton Corporate Finance senior associate

In our Fall 2004 issues of *Dealmaker*, we initiated a three-part series entitled, “How to value a company,” to explore several of the most commonly used techniques for valuing a company - the public company comparables approach, the precedent merger and acquisition (M&A) transactions and discounted cash flow modeling. In this issue, we will examine the precedent M&A transaction approach, held by many to be the best route to value a company.

Precedent M&A transaction approach

The precedent transaction approach uses recent M&A data to explore what informed buyers have been willing to pay for companies with similar characteristics to the subject company. Typically, these valuations are stated in a range of multiples of Enterprise Value (EV), to the target’s most recently available trailing twelve month (TTM) earnings before interest, taxes, depreciation, and amortization (EBITDA). In the case of an M&A transaction, enterprise value is typically defined as the equity value of the company, plus any net debt (funded debt, including minority interests, less cash and equivalents) assumed by the buyer.

When determining what transactions are relevant, it is important to select those involving companies that are as closely related to the subject company as possible and that represent a change of control (i.e. 51 percent acquired interest or greater). Once similar transactions are identified, information is gathered from various sources (including company press releases, new articles, industry journals, public filings and company presentations) in an attempt to determine the total enterprise value paid for the company and its ratio to EBITDA, revenue or other relevant variables. Unfortunately, private company transaction data is often not publicly disclosed, or when it is, data is often very limited.

Combined, the information from these transactions can not only be used to determine a potential valuation range for the subject company, but also to discern patterns in acquisition activity in an industry and to identify active buyers.

The precedent transaction approach often yields higher EBITDA multiple ranges than the public company comparables approach. The public company comparable approach, by nature, values companies from a minority, or non-control perspective, while precedent M&A transactions already take into account the additional value, or premium, buyers place on obtaining a control

position in a company. This premium represents a buyer’s perceived ability to bring about a positive change in operations with control. More importantly, multiples derived from precedent transactions often reflect cost savings, or synergies, that a buyer believes can be generated by combining the company with its existing operations - savings that are not generally disclosed to the public, but translate into higher perceived multiples.

As with all methods of valuation, the precedent transaction approach has advantages and disadvantages:

Advantages

- More accurate measure of acquisition activity and multiples
- Insight into acquisition patterns and active buyers

Disadvantages

- Publicly disclosed data is often limited
- Not always clear/directly comparable transactions
- Transaction may be significantly larger than subject company
- Often “hidden” facts and circumstances (synergies etc.) that distort transaction multiples

It is important to note that no one valuation method should be relied upon in a vacuum - multiple techniques should be considered. In the next issue of *Dealmaker*, and the final part of the “How to value a company” series, we will discuss the discounted cash flow approach to valuation in detail. ■

If you missed the first article in the “How to value a company” series, please visit www.gt.com/dealmaker

The anatomy of a sale process

As a business owner, it's hard to know what to expect when contemplating the sale of your business. At first glance, this transaction process can appear extremely daunting. Just take for example the language of dealmakers; the multitude of acronyms (e.g. EBITDA, NDA, CIM, P&S, EV, etc.) can in and of itself be confusing.

However, in truth, this cumbersome glossary of terms veils what is, for the most part, a simple process - that is, creating a market for the company and establishing what price that market will bear. In essence, the sale process, which can take anywhere from six months (a relatively quick process) to in excess of a year, is a series of distinct phases which include:

Going to market

The first step of going to market is identifying a list of likely buyers. Ideally, this list would reach well beyond the

obvious direct competitors and may include companies with complimentary products/services, adjoining markets and similar customers, as well as foreign companies and private equity investors interested in the segment. In our experience, the best buyers and the ones in a position to pay the highest price, are often strategic parties able to value (and pay for) competitive advantages that may not be readily visible in the financial statements. Examples may include a recognizable brand, strong customer relationships, a well trained sales force or intangible property.

The next step in the process is confidentiality, seeing as no company wants their customers, suppliers, competitors, and most importantly, employees to know that the company is "in play." Most transaction processes rely on the use of a non-disclosure agreement or NDA (also referred to as a

confidentiality agreement). This agreement is given to previously identified potential buyers before the name of the company is disclosed. Sometimes an anonymous description of the company will accompany the NDA as a reference point. The bare elements of an NDA will seek to preserve the confidentiality of the process (i.e. you can't tell anyone the company is for sale) and the information that is being provided to interested parties (i.e. you can only use it to evaluate the opportunity and if you are not interested we want you to return it). Additional clauses will cover such items as indemnification, no solicitation of employees and disclaimers relating to the accuracy of the information being provided.

Once an NDA is in place, information can begin to flow. More often than not that information will initially take the form of a Confidential Information Memorandum

Deal of the quarter

On Nov. 11, 2004, EMAK Worldwide, Inc. (Nasdaq: EMAK), a leading marketing services firm, announced the completion of the acquisition of Megaprint Group, Limited, a privately held creative promotions agency headquartered in the United Kingdom. Megaprint is currently generating approximately \$16.0 million in annualized revenue.

Founded in 1969 in the Netherlands, Megaprint provides a wide range of promotional tools and specializes in the creation and production of programs utilizing two-dimensional (2-D) premiums for blue-chip corporate clients primarily in Western European markets. Its two largest clients, Kellogg's and PepsiCo, together generate more than 50 percent of Megaprint's total sales. Megaprint has operations in the United Kingdom and Ireland, the Netherlands, Germany and France, and operates through sales agents in Scandinavia, the Czech Republic and the Middle East.

Don Kurz, chairman and chief executive officer of EMAK Worldwide, stated, "The trend in Fortune 1000 companies is to partner with fewer yet larger agencies with a global reach. It's important for us to continue developing critical mass by broadening our capabilities as an Grant Thornton

integrated family of marketing services agencies. Megaprint is the pan-European market leader in the innovation and production of paper and board engineered (2-D) premiums, and will allow EMAK's family of companies to expand services in this area."

Key benefits of the transaction include:

- Additional revenue stream will contribute to EMAK's growth and further diversify cash flow and earnings.
- Megaprint will team with Logistix to capture a larger portion of existing clients' marketing budgets by offering 2-D premiums, increasing cross-selling opportunities.
- The acquisition will enable Megaprint to target the worldwide market for 2-D premiums via EMAK's client relationships and global footprint, including developing markets such as Eastern Europe, Latin America and the Middle East.

Megaprint will have the opportunity to leverage EMAK's infrastructure to enhance the quality of its products and services. Megaprint also has a robust production and technical expertise to be shared with EMAK's other agencies. ■

(CIM). A CIM is essentially a “book” that describes the company and the opportunity it represents to potential buyers. CIM’s typically include information on the company’s history, its products and services, the markets it serves, its customers, its management and employees, its operations, its financial performance, and most importantly, its future prospects.

This leads us to an interesting point of discussion. Logic would tell you that the more parties you approach, the larger the market you create and the more likely you are to garner a higher price for the business. This may not necessarily be true. A broad auction may accomplish increased surety of close, in other words a better chance of successfully selling your company. However, it may make sense to approach only a few logical strategic buyers to give them the opportunity to make a pre-emptive offer, before a broad

auction is initiated. Using the threat of an auction may be sufficient to extract maximum price, but you’ll never really know if there might have been another company out there that wasn’t approached that might have paid more.

Assessing interest

So far in our transaction process we have identified a number of potential buyers, we have executed NDA’s with them and provided them with the CIM. Now what? From this point on, the transaction process is by and large dictated by the level of interest being displayed in the company. (The advisor uses the CIM to establish how much interest there is, and what that interest looks like in terms of valuations being placed on the company.) Interested parties are typically asked to submit a letter expressing their interest in the company based on the CIM. This might be referred to as an indicative offer, letter of

intent (LOI), indicative bid, or simply an expression of interest (EOI). Whatever it is called, the advisor will be looking for some key pieces of information including: the price the buyer intends to pay, the resources the buyer has to fund that purchase price and the buyer’s intentions for delivering the purchase price, i.e. what (cash or stock) and when (at closing or later). Other useful information to draw out of potential buyers at this stage might be how they arrived at the purchase price and what process they envisage to closing a transaction (due diligence, board approval, etc.).

Based on the number of expressions of interest received, the advisor will now look to qualify buyers based on the objectives of the owners. Most likely to close a deal, best price and best strategic fit may all be factors that are considered in determining which parties are to be taken through to the next stage of the process. >

Other GTCF news

Other GTCF news

Grant Thornton Corporate Finance is please to announce the following closed deals:

November 2004 - Grant Thornton Corporate Finance advised the shareholders of Megaprint Group Limited, the leading pan-European supplier of creative promotional premiums, on its sale to NASDAQ-listed EMAK Worldwide Inc., a global marketing services company headquartered in Los Angeles. Grant Thornton Corporate Finance’s Boston team advised on this transaction.

November 2004 - Grant Thornton Corporate Finance advised the shareholders of The Shelcore Group, a leading manufacturer of branded and private label plastic toys for infants and pre-school children, on its sale to Matrix Holdings Limited. Grant Thornton Corporate Finance’s Boston and Hong Kong teams worked jointly on this transaction.

October 2004 - Grant Thornton Corporate Finance advised on the \$365 million sale of Del Monte Foods Europe to Fresh Del Monte Produce Inc., re-uniting in one company the right to use the Del Monte brand for both fresh food globally and processed food in Europe, the Middle East and Africa.

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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.

In 2003, Grant Thornton International 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 International has placed in the Top 20, ranking 18th in both 2001 and 2002. Grant Thornton International has approximately 1,000 corporate finance professionals around the world. ■

The anatomy of a sale process (continued from page 3)

Not all business owners have a primary objective of maximizing price. Some business owners are more concerned about business continuity, selling to the “right” partner who can realize the full potential of the business and ensure the employees who have been so loyal for so long are well looked after. If price is a secondary issue, you are likely to employ an entirely different transaction process.

The next stage of the process will involve a greater degree of involvement of company management (up to now only the owner and chief financial officers may have been involved) and the provision of more detailed (and more sensitive) information to the short-listed buyers.

Confirming offers

Detailed information is provided to the short-listed buyers through a data room - a rather grandiose way of saying that a lot of detailed information on the company (customer contracts, detailed financial information, insurance agreements, leases, employee and payroll information etc.) is put together for buyers to review. At the same time, the advisor may also be conducting site visits and management presentations, serving as the first real opportunity buyers will be given to see the company’s facilities and meet the management team. The management presentation is usually delivered by the key individuals that the buyer will likely want to see continue on with the business post acquisition. What they are delivering is a sales pitch or what they think they can do with the company going forward.

The management presentation can be a critical point in the transaction process. A CIM can only convey so much about the company, and raw data in a data room is turgid, but watching a management team

talk about the company they run with enthusiasm and excitement can really energize a buyer and push their interest level over the edge.

Following presentations, site visits and data room reviews, the advisor will typically ask the short listed bidders to submit a final offer. This is a more robust version of the original expression of interest, containing more detailed information on the terms and conditions the buyer is proposing to consummate the transaction. If the advisor has done a good job, it should also contain far less caveats, contingencies and get-out options than the original offer, and ideally, a higher price. In some cases, at the same time as requesting a final bid, the advisor may also distribute to each of the short-listed buyers a draft copy of the proposed Purchase and Sale Agreement (P&S) - the document that would formalize the transaction, prepared by the company’s attorney. The buyers would be asked to review the P&S and submit a mark-up highlighting any changes they require along with their final bid. The intention here is to draw out any potential deal breakers that may arise in legal documentation, most typically surrounding issues such as escrows and hold-backs, indemnifications and the related baskets and caps, representations and warranties etc.

Transaction completion

By now, the advisor and owners should have a very clear understanding of who the most interested parties are, as well as the terms and conditions under which a transaction could be consummated with each of them. It’s now time to pick the winning bidder. Some auction processes do involve multiple bidders being taken through final due diligence and

negotiations to the very end of the process, but in most cases, a single bidder is chosen to move forward. The selection of the winning bidder is formalized with the execution of a term sheet or letter of intent that sets out the intentions of both parties to close the deal within a given time frame - usually around 60 days - with the remaining action items being final due diligence and legal documentation.

In final due diligence, the emphasis switches from the advisor determining what information should be provided to the buyer requesting any and all of the information they would like their accounting, legal and other advisors to review before they sign the P&S. This is the point in the process where extremely sensitive information (typically customer related) inevitably must be handed over. Concurrent with final due diligence, the legal teams on each side of the transaction will be hammering out the documents that will formalize the deal, with the principal one being the P&S. Ancillary agreements would include the escrow agreement, non-compete agreements, employment contracts, transition agreements etc. Should anything arise in the final due diligence process, there may be some re-negotiation of terms, but if the advisor has done the job properly all of the major deal issues should have been disclosed prior to requesting final bids. There is little to be gained by delaying the delivery of bad news to buyers.

Conclusion

The professional sales process can be a great asset to owners as they try to sell their company, helping the business to yield better returns and greater surety of close. ■