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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 raises questions about the relevance of revenue multiples

By Christopher Kampe, Grant Thornton Corporate Finance LLC director

Synopsis: Grant Thornton Corporate Finance LLC recently concluded its second annual mid-market valuation study. The study incorporated new Mergers and acquisitions (M&A) data from 170 mid-market transactions announced during 2006, along with more than 1,000 mid-market transactions announced between 2000 and 2005. Beyond tracking current mid-market valuation trends, the study made a number of interesting observations, including:

- *Decrease in the valuation multiples in the Industrial and Materials sectors*
- *Impact of deal size on valuation multiples*
- *Relevance of revenue multiples*

General valuation trends

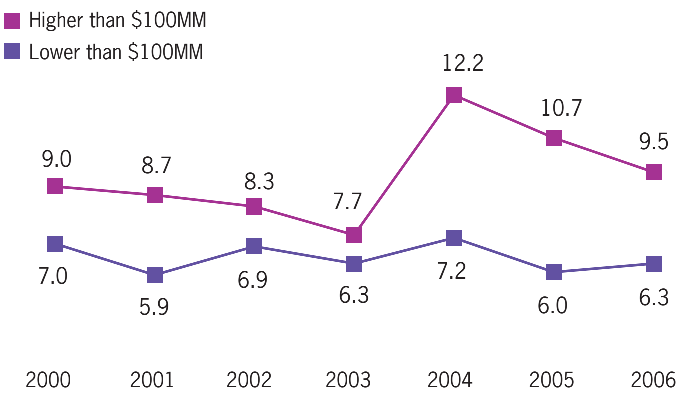
Mid-market M&A valuations remained high in 2006, though median pricing has fallen from the lofty levels of 2005. The median-enterprise-value-to-EBITDA (earnings before interest, taxes, depreciation and amortization) multiple was 8.7 in 2006, compared to 9.7 for 2005. Notably, while general valuation data is helpful to spot and track trends, it is important to keep in mind that valuation multiples can and do differ widely by industry and are often heavily influenced by growth rates. For instance, multiples in the mature Consumer, Energy, Materials and Industrial sectors have, over time, been consistently lower than those in faster-growing Information Technology and Healthcare sectors.

Industry-specific data

Interestingly, during 2006, many sectors, including Materials, Industrials, Information Technology and Healthcare, began to show sharp declines in valuation multiples. For example, both Materials and Industrials, widely believed to be highly cyclical and relatively capital-intensive industries, saw valuation multiples fall from in excess of 8.0 in 2005 to roughly 6.5 in 2006. We attribute the weakness in Materials to the contraction in the housing industry during 2006. Lower Industrial valuations may be the result of the slowing U.S. economy and weakness in interest rate-sensitive sectors such as Automotive.

Conversely, valuations in the Consumer and Energy sectors continued to increase in 2006, with median middle-market Consumer Discretionary multiples now approaching 9.0 times EBITDA. While higher multiples in the Energy sector were a direct result of record-high oil prices, trends in the Consumer sector are more subtle — continued consumer spending (albeit at slower growth rates), growth in wages and low unemployment. >

Median EV/EBITDA multiples for the industrial sector



The impact of size on relative value

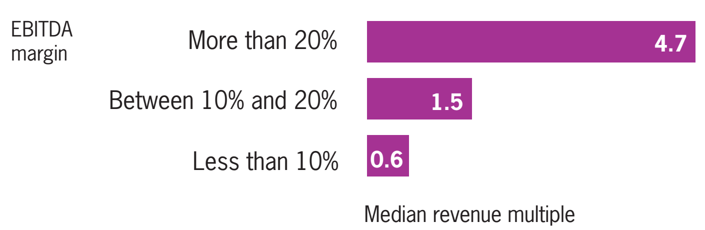
With the new 2006 data, we decided to re-test our previous conclusion that larger companies and bigger deals generally sold at higher relative valuation multiples than smaller ones. While this trend had held up reasonably well over time, surprisingly, we found that the valuation gap that had existed between larger and small transactions had narrowed in 2006. Specifically, the median enterprise value to-EBITDA multiple for transactions valued between $100 and $200 million was 9.0 in 2006, while the median EV-to-EBITDA multiple for transactions between $10 snd $100 million was 8.6. We further explored the impact of size on valuation within broad industry groups and found that in 2006, only the Industrial sector displayed a dramatic valuation difference between bigger and smaller transactions. We attribute size premiums to economies of scale in the industrial sector, often perceived by investors to lower risk. We also note that many smaller industrial companies have significant customer concentrations and often compete against much larger players. These characteristics can increase a target's risk profile and thus lower its relative valuation.

The relevance of revenue multiples

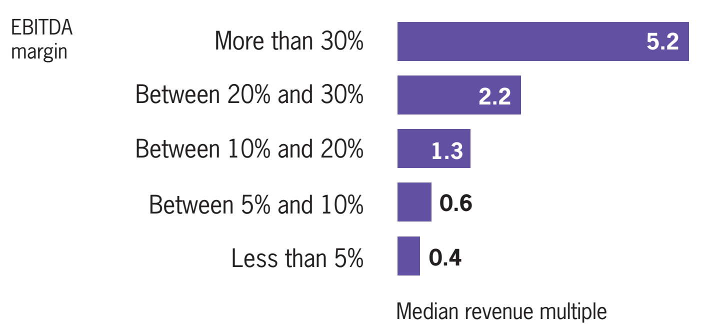
Noting that many business owners appear to be fixated on revenue multiples as the quintessential valuation metric, we decided to look at just how relevant this statistic was as a predictive yardstick. The results surprised us.

Theory holds that the value of any investment can be calculated by estimating its future cash flows and then discounting these back to the present using a risk-adjusted required rate of return. In many industries, especially mature sectors exhibiting lower growth rates, EBITDA has been found to be a strong indicator of future cash flows. However, in certain circumstances, such as new companies in sectors such as information technology, or in underperforming businesses, we have, in the past, found a closer correlation of value to revenue multiples. Not so in 2006, when the market appeared to value profits more than revenues, even in technology companies. For example, for information technology companies with EBITDA margins in excess of 20 percent, the median revenue multiple was 4.7. In contrast, for those information technology companies with EBITDA margins less than 10 percent, the median revenue multiple was only 0.6.

The relevance of revenue mulitples in the information technology industry

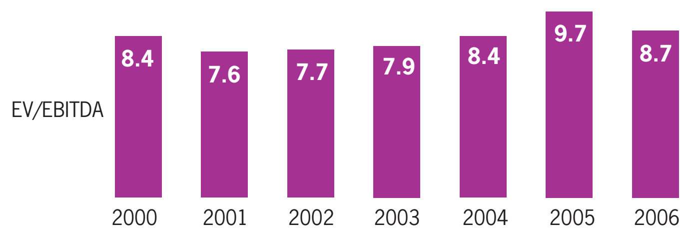


The relevance of revenue mulitples (middle market, all industries)

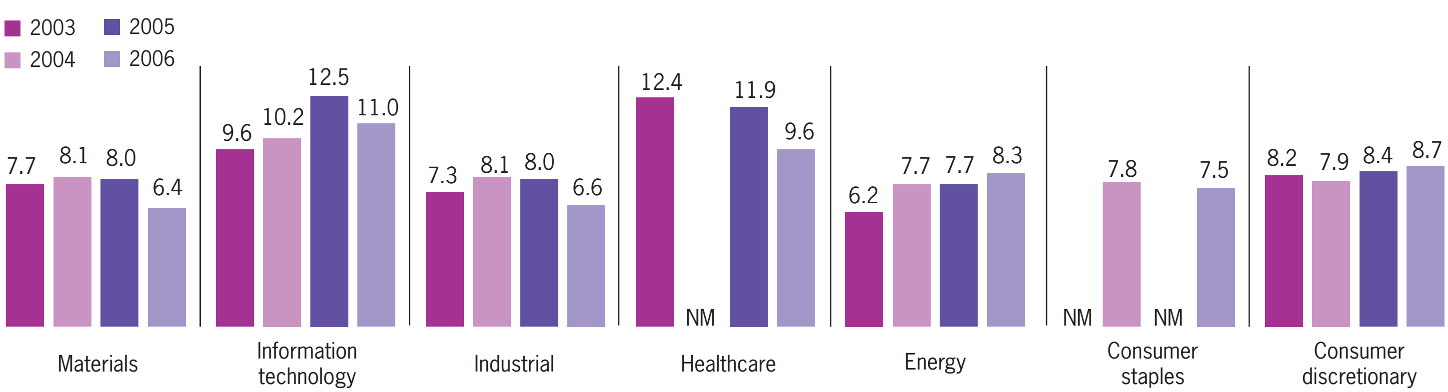


The data supports a clear correlation between EBITDA margins and revenue multiples achieved-thus, the more profitable a company is, the higher the expected enterprise value to revenue multiple. While this relationship may appear intuitive and rather elementary, it is an important reminder that profits do, in fact, matter in determining value. ■

Median EV/EBITDA multiples
transactions between $10MM - $200MM for all industries



Median EV/EBITDA multiples - transactions between $10MM - 200MM



Source: CapitalIQ

M&A market update

According to Mergerstat™, 9,313 net M&A transactions were announced in 2006 in the United States, making the year the second-most-active in history. "We are now in our fourth year of a cyclical M&A boom that began in 2004," says George Shaw, managing director of Grant Thornton Corporate Finance LLC. Shaw reported that "the real driver behind 2006 M&A activity is strong corporate profits, but the single most important trend has been the explosion of the private-equity market."

Vast amounts of capital have been pouring into private-equity funds, which generally seek to invest in privately-held companies. According to *Buyouts*, a publication covering the private-equity market, more than $130 billion was raised by private-equity funds for buyouts in 2006 alone, up from $106 billion in 2005. "The unprecedented amount of capital flowing into the M&A market has resulted in unusually robust interest in privately held business auctions, increased competition and higher valuations," says Shaw. "Additionally, faced with fewer investment choices, private equity groups are now investing in sectors they once avoided, such as retail, creating new liquidity options for middle market business owners." Based on Grant Thornton research, private equity-backed buyouts now represent about 20 percent of the U.S. M&A market. ■

Deal of the quarter

Grant Thornton Corporate Finance LLC recently acted as exclusive financial adviser to Oxy-Dry Corp. on its sale to Baldwin Technology Co. Inc.

Oxy-Dry is a leading manufacturer of custom-engineered automatic blanket-washing systems used in newspaper and commercial print markets. The business was acquired by Baldwin Technology, a global leader in accessories and controls technology for the printing industry.

"The acquisition of Oxy-Dry makes Baldwin the leading global full solution provider of cleaning applications in the offset printing market," said Karl Puehringer, chief executive officer of Baldwin Technology.

While Oxy-Dry was headquartered in a suburb of Chicago, the majority of its employees were situated outside of the United States (primarily Europe), making it a true multinational corporation. The company's principal manufacturing operation was located near Frankfurt, Germany. Because success in selling the company hinged on the investment banker's international distribution capabilities Oxy-Dry appointed Grant Thornton Corporate Finance LLC over others because of its global reach.

"We employed a five-person, cross-border team on the assignment, and approached potential partners in the United States and Europe in their local language," says Stephen McGee, executive director of Grant Thornton Corporate Finance LLC, who co-led the assignment with Kampe. "Few other investment banking organizations are truly capable of employing multinational teams on lower middle-market transactions."

Martin Haver, former chief financial officer of Oxy-Dry Corp., said: "Grant Thornton Corporate Finance's services were first-class; the quality of personnel and international coordination and their management of the process were instrumental in realizing a premium valuation for the business."

Baldwin Technology Company, Inc. is a leading international supplier of offset printing press accessories and controls for the newspaper publishing and commercial printing industries. Baldwin offers its customers a broad range of market-leading technologies, products and systems that enhance the quality of printed products and improve the economic and environmental efficiency of printing presses. ■

Grant Thornton Corporate Finance news

1. Oct. 2006: Grant Thornton Corporate Finance LLC acted as exclusive financial adviser to RTP Co., a leading plastics compounder, on its acquisition of Wyman Corp. Stephen McGee, executive director, led the transaction team.

2. Oct. 2006 - Grant Thornton Corporate Finance advised Performance Products Limited, a manufacturer of GPS systems and personal navigation devices, on its sale to Cobra Electronics Corporation (NASDAQ: COBR), a leading global manufacturer of navigation and communication products.

3. Nov. 22, 2006 - Grant Thornton Corporate Finance advised Oxy-Dry Corp. on its sale to Baldwin Technology Co. Inc., a recognized leader in accessories and controls for the graphic arts industry. Stephen McGee, executive director, and Christopher Kampe, director, co-led a cross-border transaction team staffed by professionals in both the U.S. and Germany.

4. January 2007 - Grant Thornton Corporate Finance advised Saxby Bros. Limited, a manufacturer of refrigerated pastry, to General Mills, a leading manufacturer of packaged consumer foods.

5. January 4, 2007 - Grant Thornton Corporate Finance announced that Amanda Symonds joined the Boston office as senior associate. Amanda arrives from Grant Thornton Corporate Finance's lead advisory office in Manchester, England, where she advised on M&A in the Consumer, Healthcare and Industrial sectors. Amanda is a graduate of the University of Leeds in England.

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.