By Andrew Bohutinsky

Will M&A Activity Maintain Its 2004 Pace?

The past year proved to be robust for merger and acquisition activity, with more transactions reported in 2004 than in any of the past three years. While many economic factors contributed to this improvement, perhaps the most profound reason for the pick up was the willingness of lenders to make more money available at increasingly attractive rates.

Lenders' willingness to lend typically moves in cycles. Following the tragedies of September 11, 2001, and the subsequent recession, banks significantly reduced the amount of capital they were willing to lend, shutting down many M&A efforts and reducing purchase prices for many companies. In 2004, this situation reversed itself, with banks and other sources of capital opening their spigots and lending larger amounts of capital for acquisitions. This reversal, combined with a strong residential construction market, made for a very favorable year for M&A in the window and door industry.

There are two primary types of buyers in today's marketplace: private equity firms and companies looking to grow through acquisition (what we call "strategic buyers"). The amount and terms of available financing are typically more important determinants of purchase price for private equity buyers than strategic buyers. This is because strategic buyers often have other financial tools at their disposal, such as large cash balances and stock that can be utilized for acquisitions.

PRIVATE EQUITY

With lenders willing to part with larger amounts, private equity groups aggressively sought acquisition opportunities, often outbidding strategic acquirers this past year. With extraordinary amounts of unspent capital ready to invest, private equity firms made a number of high-profile acquisitions in the window and door industry, including Caxton-Iseman Capital, which acquired Ply Gem Industries; Linsalata Capital Partners, which acquired Alenco Windows; and JLL Partners, which acquired PGT Industries. In addition, Kohlberg Kravis & Roberts signed an agreement to acquire Masonite, one of the largest companies in the *Window & Door* Top 100, for US$2.5 billion, with the transaction expected to close late this month.

With private equity buyers leading the charge, strong M&A conditions are resulting in increasingly higher purchase price multiples (purchase price expressed as a multiple of a company's earnings) for most companies in the window and door industry. In terms of private equity deals overall, purchase price multiples are currently at levels not seen since the late 1990s (*Fig. 1*).

Average Private Equity Purchase Price
as a multiple of trailing 12-month EBITDA

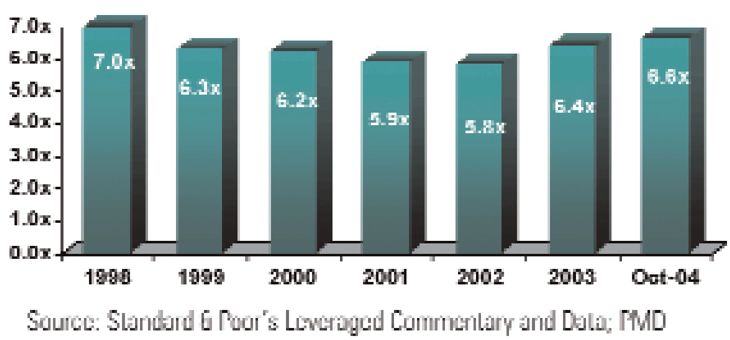

Figure 1

One example of a window and door transaction that illustrates the improved M&A environment is the August 2004 purchase of MW Manufacturers, a window manufacturer, by Ply-Gem Industries (which is backed by Caxton-Iseman Capital). MW's previous owner, Investcorp, bought the company in January 2003 for $188 million, which represented an approximate 6.5x multiple of trailing 12-month earnings before interest, taxes, depreciation and amortization (EBITDA). In August 2004, by taking advantage of an improved M&A market and by implementing improvements in the business, Investcorp was able to sell MW for $320 million, about 8.0 times trailing 12-month EBITDA. In only 18 months time, Investcorp nearly doubled its purchase price.

The past year also saw a shift in how private equity acquirers approach acquisitions. The relatively high purchase price multiples paid in 2004 will force acquirers to improve the value of their investment the old-fashioned way: by developing a strategy that emphasizes continued growth, operational improvements and a carefully planned sale of the company in the future. This includes working with the company's management team to improve the firm's intrinsic value, as well as seeking additional add-on acquisitions that extend the company's product line, customer penetration, etc. Accordingly, we expect that many private equity buyers of window and door companies in 2004 will continue to be active acquirers for the next several years as they seek to bolster their company through additional acquisitions.

This is already evident at Atrium Cos., acquired in December 2003 by Kenner & Co. Inc., a private equity firm based in New York. Atrium Cos. is an example of a private equity-backed company that has sought to bolster its product line, customer base and geographic coverage through acquisition. Since being acquired by Kenner & Co., Atrium has gone on to acquire several companies, including three in 2004: Kinco (September 2004), West Coast Custom Finish (August 2004) and Robico Shutters (June 2004). Atrium's acquisitions have allowed the company to extend its product line and services and to further penetrate new markets. We expect Atrium to continue its acquisition push in 2005 as it seeks further penetration in certain high-growth geographic areas.

STRATEGIC BUYERS

Strategic buyers in the window and door industry were much quieter than private equity buyers in 2004, preferring to focus on smaller acquisitions that added to their product offering, customer base or geographic coverage. Notable strategic buyers included Gienow Building Products (Farley Windows in October 2004), Therma-Tru (the UK's Sentinel Doors Ltd. in June 2004) and Jeld-Wen (Windowmaster in February 2004 and Seasonshield in December 2004). We expect strategic buyers to become more active in 2005 and start to compete with private equity buyers for acquisitions of window and door companies, as corporate earnings and the stock market have improved, leading to larger cash hoards and higher-valued stock to use as currency in an acquisition.

While no one can pinpoint exactly how long this plush M&A market will last, the expected increase in interest rates throughout 2005 and the inevitable contraction in the lending cycle could lead to private equity activity slowing in 2006. Moreover, the pace of private equity deals will slow as firms hold on to their investments for longer periods of time as they work to reap returns from acquisitions made at relatively high purchase price multiples. If current trends continue, strategic buyers could start to pick up the slack from less active private equity buyers in 2005, and lead to continued health in the M&A market in 2006.

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