

MERGERS, ACQUISITIONS AND OPPORTUNITIES

EAGLE | Asset Management

After several years in which worldwide mergers-and-acquisitions (M&A) activity dropped steeply, corporate dealmaking could make a comeback in 2011, according to surveys from Thomson Reuters and mergermarket.com. Corporate cash balances are near record highs, and management teams are turning to mergers and acquisitions to create shareholder value, a trend that is likely to continue over the next 12 to 18 months.

Last year saw worldwide small-cap M&A deals (valued up to \$50 million) jump 14.7 percent over the previous year, especially among technology, healthcare and industrial names, according to a Thomson Reuters report. The Small Cap Core Value team at Eagle Boston Investment Management, a subsidiary of Eagle Asset Management, witnessed the same trend in their portfolios, as several holdings were acquired by larger competitors or private-equity groups during 2010.

Examples of Eagle Boston Small Cap Core Value Mergers & Acquisitions Activity for 2010

Syniverse Holdings , a provider of technology services to wireless-telecommunications companies	The company appreciated 35 percent after announcing it would be acquired by a private-equity group.
AGL Resources , a Georgia-based utility and distribution company	AGL dropped after it announced a merger with Nicor, a competing gas distributor. The deal isn't expected to benefit earnings for at least 12 months. The team will monitor the details but continues to hold it because they believe the company will work through its short-term challenges and provide solid long-term returns.
Psychiatric Solutions , an operator of inpatient and outpatient psychiatric care facilities	The stock rose as the previously announced tentative take private transaction was formalized. Psychiatric Solutions was acquired by competitor Universal Health Services in the fourth quarter.
Interactive Data , a provider of financial-market data and analytical services	The stock appreciated after it announced the company's largest shareholder was pursuing a sale of the entire company to a third party. The company was eventually acquired by a private-equity firm.
SonicWALL makes internet-security appliances	The stock appreciated on an announcement it was being acquired by private-equity buyers.

Portfolio Co-managers Dave Adams, CFA, and Jack McPherson, CFA, have seen this cycle before in their more than 20 years of investing. In their experience, acquiring companies pay a premium for these usually smaller targets, creating opportunities particularly for investors in the small-capitalization space. This is not to imply that the team targets companies based on their likeliness to be acquired. Instead, the Small Cap Core Value team prefers to buy high-quality names that generate free-cash flow, which may make their holdings targets for takeouts and they expect to see increased activity in the years ahead.

Defining Quality

Higher beta, lower quality equities were the primary driver of the Russell 2000 benchmark in 2010. Stocks with a trailing beta of 2.0 or greater outperformed stocks with a beta of 1.0 or less. The Small Cap Core Value team's higher quality bias tends to leave them under exposed to higher beta names. In fact, the strategy's beta has consistently been at or below their peer group average, according to CAI data, as of Dec. 31, 2010.

However, high-quality stocks are now trading at similar valuations to low-quality names and are relatively cheap. This allows the team to buy higher quality names at what they consider reasonable valuations. They define quality in terms of beta, a stock's sensitivity to market movements. It is clear to these portfolio managers that focusing on quality remains essential for long-term investors.

To learn more about Eagle Boston's Small Cap Core Value program, please visit eagleasset.com.

Past performance is no guarantee of future results. Investing in securities may result in a loss of capital.

There is no assurance that a separately managed account will achieve its investment objective. Separately managed accounts are subject to market risk, which is the possibility that the market values of securities owned will decline and that the value of the securities may therefore be less than what you paid for them. Accordingly, you can lose money investing in a separately managed account.

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