Middle Market Investment Bankers

Bringing Efficiency to Inefficient Markets

2012

M&A AND CORPORATE FINANCE OVERVIEW

Second Quarter

Merger & Acquisition
Corporate Finance Advisory
Strategic Consulting

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Strategic Advisors is a middle market investment banking firm that helps clients achieve financial and business goals by providing merger and acquisition advisory, corporate finance advisory and strategic consulting services. Along with many years of experience in advising middle market clients, our Managing Directors have experience investing in and managing portfolio companies. As such, Strategic Advisors not only has expertise in advisory services but also firsthand knowledge of what stakeholders, investors and lenders expect and desire.

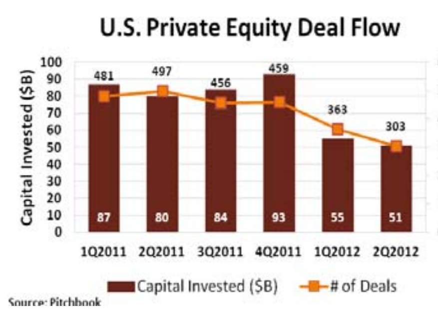
Merger and Acquisition Overview

- Well here we go again. While it appeared that the U.S. may finally have been primed for a full-fledged recovery and the predicament in Europe may have finally stabilized, that rosy reality has failed to materialize. All of a sudden the outlook appears to be much gloomier. The United States economy has continued to show considerable weakness. High levels of uncertainty pertaining to taxation, regulation, and the impending presidential election continue to hold back investment and thus economic growth. This is the third straight year where promising improvements in the economic activity recorded in the first quarter have been followed by a slowdown in economic activity in the following summer months. Tiny rays of economic light are being trampled by negative market sentiment.

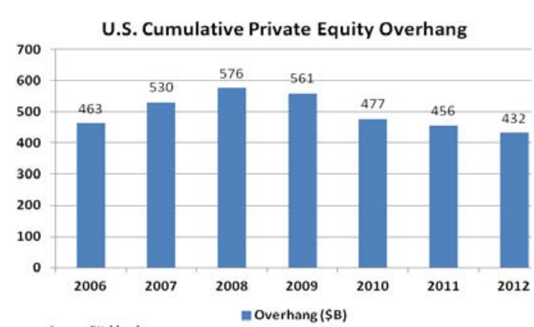
- The Small Business Optimism Index as reported by National Federation of Small Businesses (NFIB) is now on a steady decline. In July it dropped by 0.2 points, falling to 91.2, which was its third consecutive monthly decrease. The NFIB states that owner optimism has remained at recession level for the last three years, oscillating between 86.5 (7/09) to 94.5 (2/12). Prior to 2008 this index averaged 100; significantly over the current reading.

- In this report we will examine second quarter activity, and review the year to date. Some of the highlights include a further drop in deal volume, which has been in a steady decline for over a year; the lowest level of PE investment since 2009; and year-over-year declines in exit volume and capital. Pitchbook, in their 3rd quarter Private Equity Breakdown, notes the only optimism was the increased level of fundraising, which is normally a leading indicator of activity to come.

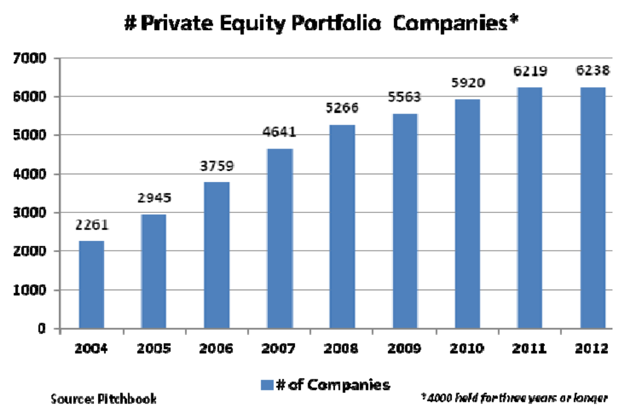
- 2012 private equity activity is off to a slower start compared to recent years. Pitchbook notes the amount of capital invested in the second quarter decreased by 8% from the previous quarter. A more drastic decline came in deal volume, which fell 17%. They further note that when comparing the 2nd quarter volume to the same period in 2011, the results are even worse, showing a decline of 39% in deal volume and 37% in invested capital. In the second quarter only $51 billion was invested; the lowest level for any quarter since 2008.



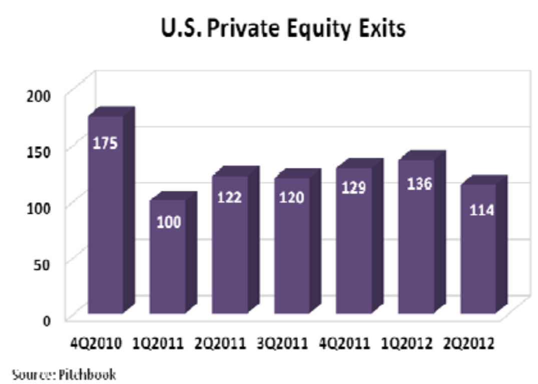
- Private equity groups (PEGs) continued to be dissuaded from completing transactions by the fear of the U.S. potentially entering another recession. However, this trend will likely change as PE firms will have to make a concerted effort to prudently invest their more than $430 billion of dry powder.



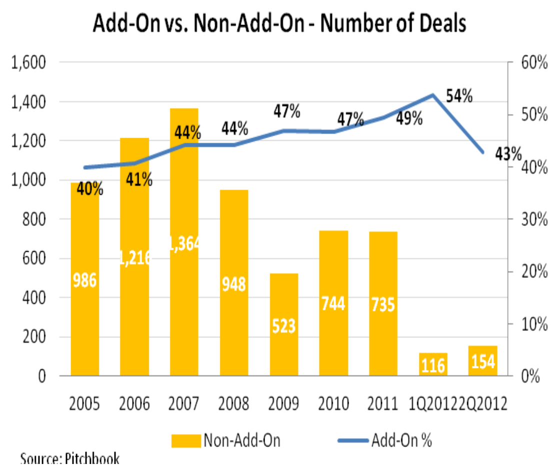
- Pitchbook also believes that PEG's with a significant inventory of PE-backed companies sitting in their portfolios, 64.5% of which have been held for three years or longer, and the looming fiscal cliff should further drive deal volume.



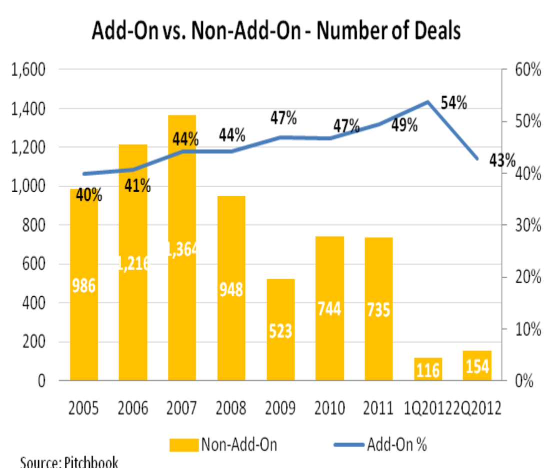
- For the fourth consecutive quarter, U.S. PEGs exited over 100 investments. Overall in 2011, U.S. PEGs exited approximately 420 investments. While this activity was slightly lower than in 2010, it was over double the exits transacted in 2009. Sales to strategic acquirers (corporate acquisitions) remained the most common exit strategy; with 66 such exits completed in 1Q 2012 totaling $16 billion of capital.



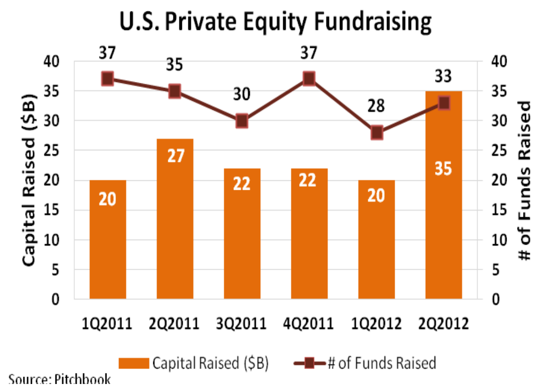
- Private equity exit activity fell slightly in 2Q 2012 with 114 companies sold or taken public. In 1Q 2012, 136 companies were sold while 122 companies were sold a year ago in 2Q 2011. The percentage of IPO's accounted for 8% of the exits during the 2nd quarter.



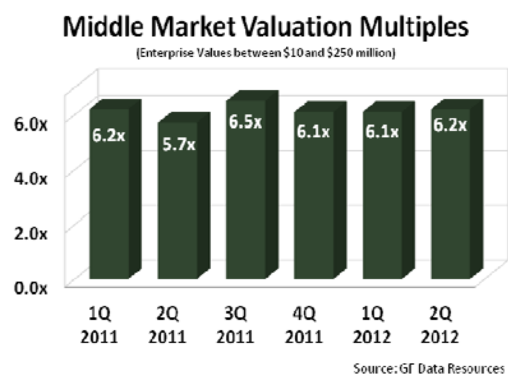
- Add-ons accounted for more than half (48%) of the buyout activity in 2Q 2012, with Private Equity backed companies. adding on 250 companies. Since 2005, add-ons, as a percentage of yearly buyout activity, have been on a steady upward trend. Five years ago, add-on transactions comprised approximately 40% of all U.S. PEG transactions.



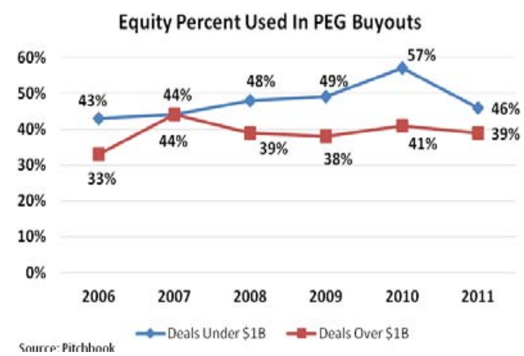
- As seen in the chart on the next page, U.S. Private Equity fundraising rebounded strongly in the 2Q 2012. Although dealmakers were frustrated by the declining deal volume, institutional investors seem to be bullish on the future of deal-making. In the 2Q 2012, thirty-three (33) funds closed with a total of $35 billion in capital commitments, which was a marked improvement over 1Q 2012. In the first quarter, 28 funds closed totaling $20 billion in commitments.



The runoff of the dry powder and the healthy level of exits seem to have convinced fund managers and investors that the PE industry has found its footing; finally adapting to the current economic environment and the subdued deal-making markets.



- ❖ U.S. middle market transaction multiples for businesses sold to financial firms averaged approximately 6.2x EBITDA in the second quarter of 2012, according to GF Data Resources. Valuations continue to oscillate around 6.0x EBITDA as seesawing economic indicators make it difficult to forecast where the economy is heading. Larger middle market deals ($50 to $250 million) continue to demand higher multiples as financial buyers face pressure to employ their investible assets before their investment periods expire. Financial buyers are working hard to find platforms to invest in, often paying a quality premium for a business with above-average financial characteristics.

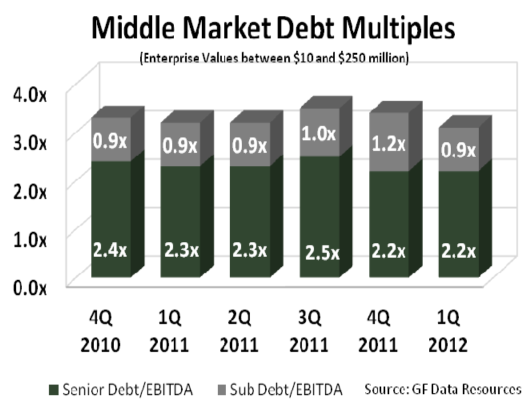


- ❖ While the equity contribution to a capital structure is down slightly from previous years, equity still makes up 46% of a transaction's capitalization.

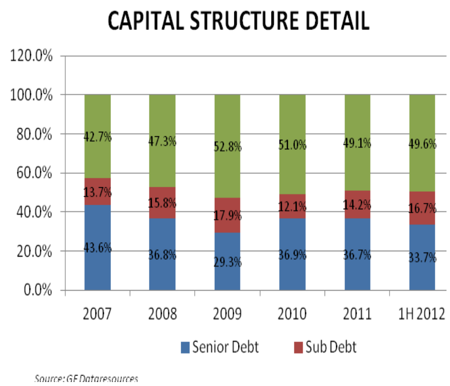
Capital Markets Overview

- Debt structures for middle market leveraged deals decreased in 2Q 2012 compared with 1Q 2012. An uncertain outlook on the U.S. economy has caused lenders to step back and be more cautious. However, the scarcity of high quality deals continues to push down pricing as lenders are aggressively competing. The debt market clearly bifurcates at $10 million of EBITDA, where lenders become more flexible in structure and pricing and generally are more lenient regarding their equity requirements.

- The growing presence of the one-stop financing approach, as well as an increasing number of mezzanine lenders, continue to become an increasing part of capital structures and stand ready to fill any void in the market.



- Although bank financing is plentiful and aggressively priced, banks have become more conservative on structure, resulting in senior debt accounting for only about a one-third of an average buyout transaction's capital structure. These conservative leverage ratios are establishing upper limits on financial buyer valuations.



- On average, senior debt pricing continues to hover around 5.0% as all-in pricing for middle market deals was approximately 5.1% in 2Q 2012, down slightly from the 5.3% in 1Q 2012.

- In forecasting M&A activity in 2012, the overall health of the global economy is the primary focal point that must be evaluated. The continued volatility of the action plan for the debt crisis in the European Union has caused concern amongst investors. Various European countries continue to reveal additional signs of weakness and appear to be deteriorating further. Compounding matters is the continued weakening of the U.S. economy and the uncertainty of the tax environment, which has caused investors to pause and proceed with extreme caution. At this point, the outlook for deal activity looks gloomy for the remainder of 2012.

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For more information, please contact any of the professionals listed below or visit our website at www.strategicad.com

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When considering a sale of your business, the acquisition of a business, or the restructuring or recapitalization of your balance sheet, the best pathway for achieving your expectations is a well-run sale process that addresses all your business and personal goals. Strategic Advisors is accustomed to working with business owners to determine the best pathway to achieve their goals and objectives. Give us a call to discuss your possibilities.

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Sources: Pitchbook - The Private Equity 3Q 2012 Breakdown; GF Data Resources August 2012 Report; NFIB Small Business Economic Trends, August 2012

Important Information