

# Middle Market M&A Review

## First Quarter 2008

Volume Q1 2008

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Elliott Davis Capital Partners is a regional investment banking firm providing a complete range of services including:

- Merger and Acquisition Advice
- Private Capital Raising
- Restructurings
- Recapitalization
- Corporate Advisory Services

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### **Elliott Davis Capital Partners, LLC - Managing Director Letter**

Happy New Year and welcome to the Elliott Davis Capital Partners First Quarter 2008 Quarterly Update. We at Elliott Davis Capital Partners hope you had a healthy and successful 2007, and wish you continued success in 2008. Despite the economic challenges of the last half of the year, 2007 was a tremendously active year for buyers and sellers. According to Mergerstat, more than 10,677 transactions were announced, worth an estimated \$1.4 trillion. While middle-market deal volume decreased 17% from the comparable period in 2006, 2007 was still one of the most active years in recent history. In addition, companies looking to raise funds for growth found a receptive audience with investors and lenders who remained anxious to work with early-stage and established middle-market businesses with compelling growth prospects.

The decrease in volume over the latter part of 2007 was primarily driven by a reduction in available credit. Although this was most evident with large transactions, the average middle-market leverage multiple decreased from 4.9X EBITDA (Q2, 2007) to 4.3X EBITDA (Q3, 2007). The result of this decrease in available credit has been a slight decrease in valuation multiples during the second half of 2007. From a broader market perspective, the turmoil in the credit markets seemed to have carried over to the financial markets with the S&P 500 down 5.1% from October 1, 2007 to December 31, 2007. This downward trend has continued into 2008 as fears of a recession have been fueled by continued struggles in the housing market and weaker-than-expected employment news with a December jobs report which reported fewer new jobs in the December (net 18,000) than had been forecasted (net 70,000), and an increase in the unemployment rate to 5%, a two-year high.

We do not believe its all gloom and doom for 2008. Despite the well publicized volatility in the capital and financial markets on Wall Street, we believe that activity in the lower middle market (i.e. Main Street) will not be as negatively impacted. We believe that the core drivers of activity in the lower middle market, including the record availability of equity capital, the desire of baby boomers to cash out, and a closing capital gains tax window, remain unchanged. Though overall valuation multiples may decline in concert with the decrease in leverage multiples, it is unlikely the decline will precipitate a dramatic decrease in transaction volumes in the lower middle-market.

Working predominantly with privately-held businesses, the professionals of Elliott Davis Capital Partners recognize that the decision to raise capital or sell a company is a difficult one to make. Specifically, owners need to understand the benefits and disadvantages of these decisions, as well as the impact they can have on a business. Working together with the tax, estate and wealth management professionals of Elliott Davis, Elliott Davis Capital Partners is uniquely positioned to help clients decipher the increasing complexities their businesses face. We hope you find this newsletter informative and will not hesitate to give us a call to answer any questions you may have.

Sincerely,

*Derik Reynecke*

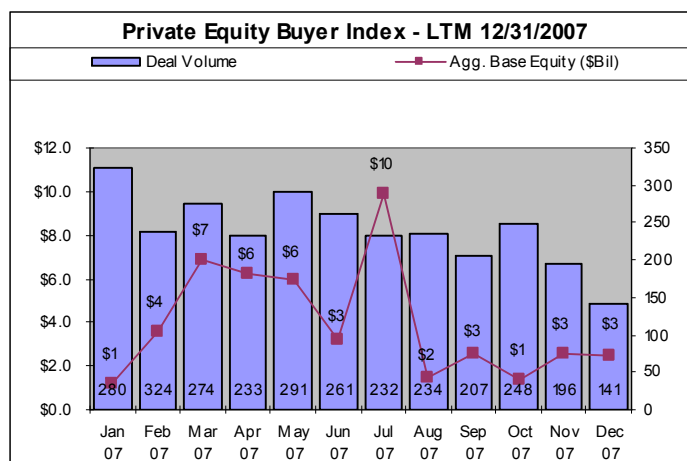
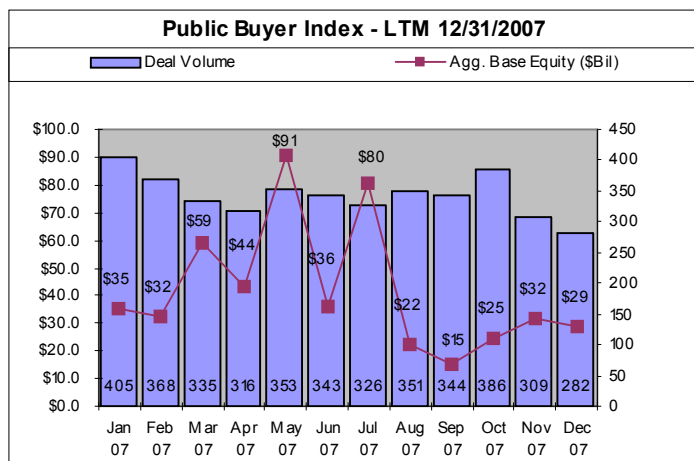
Vice President

**ElliottDavis**  
Capital Partners

# Middle Market Transaction Update and Overview

US Lower Middle Market M&A Transaction Metrics						
Deal Size (\$ mm)	Number of Transactions			Aggregate Base Equity (\$ mm)		
	TTM Ended			TTM Ended		
	12/31/07	12/31/06	Change	12/31/07	12/31/06	Change
<b>\$100 - \$250</b>	413	464	-11%	\$65,800	\$73,600	-11%
<b>\$50 - \$100</b>	436	481	-9%	\$30,600	\$33,800	-9%
<b>\$25 - \$50</b>	439	570	-23%	\$15,700	\$20,100	-22%
<b>\$10 - \$25</b>	557	685	-19%	\$8,900	\$11,000	-19%
<b>Under \$10</b>	853	1,057	-19%	\$3,700	\$4,400	-16%
<b>Total</b>	2,698	3,257	-17%	\$124,700	\$142,900	-13%

Source: FactSet MergerStat

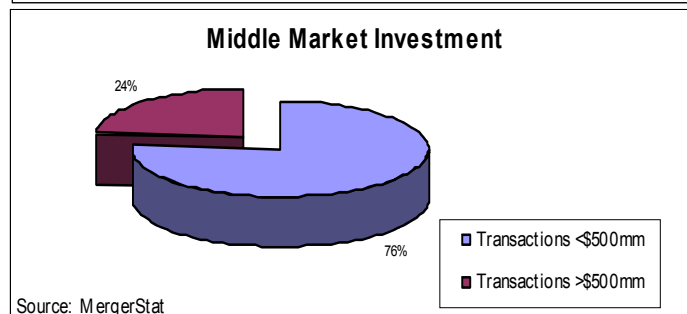
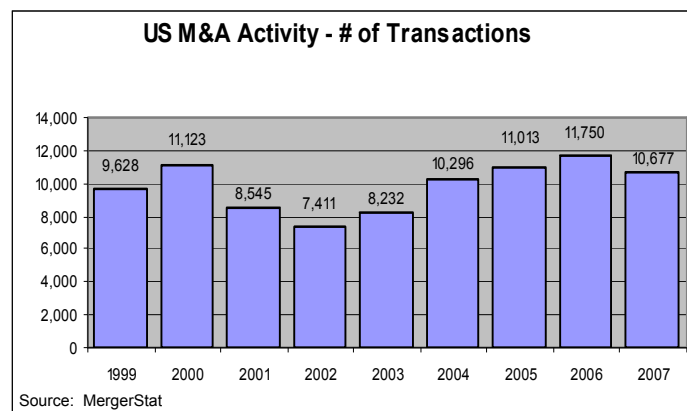


Source: FactSet MergerStat

Source: FactSet MergerStat

## Highlights

- For the TTM ended 12/31/2007, transaction activity under \$250 million was down 17% when compared to the strong deal activity over the same period in 2006. Total transaction values were lower by 13% as larger deals pushed aggregate M&A dollar volumes up to compensate for lower activity.
- Activity by Private Equity buyers slowed, resulting in September, November and December being the slowest months in the past year. M&A spending by PE buyers sank to its lowest level in the past 12 months. Most of this can be explained by the ongoing turmoil in the credit markets.
- Middle market M&A investment activity (i.e. transactions less than \$500 million) continues to dominate the M&A market, representing approximately 76% of all transactions.
- The tables on page 4 indicate that both EBITDA valuation multiples, as well as leverage multiples for middle-market M&A are down slightly compared to the first half of 2007 and prior years; again most of this can be explained by the ongoing turmoil in the credit markets.

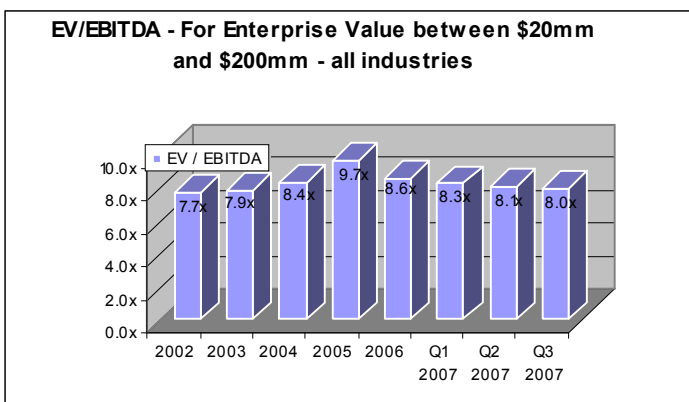


## M&A Transaction Deal Volume and Valuation Statistics

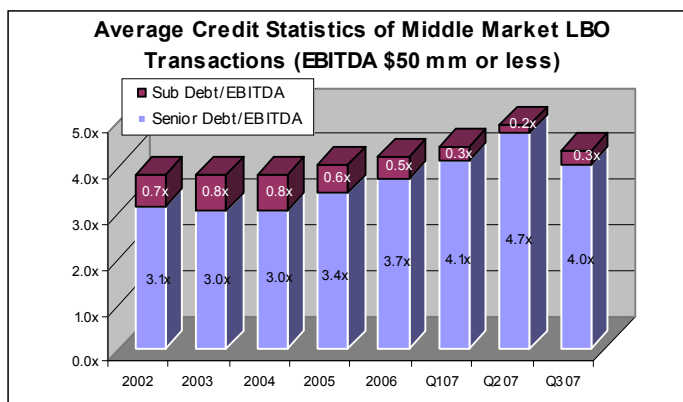
A company's value is usually determined by its financial performance, relevant benchmark industry financial performance, capital expenditure intensity as well as numerous other external, non-controllable factors, such as the industry in which it operates, current economic conditions, restrictive regulations and relevant M&A activity. Strategic buyers are sometimes willing to pay significant premiums due to product and/or other synergies. These factors result in valuations that often vary significantly from company to company, even in the same industry. As such, average EBITDA multiples can be a bit misleading. Nonetheless, averages can help provide a meaningful historical perspective for business owners and their advisors. The following table outlines the deal volume for a wide range of industries as well as the range in average EBITDA multiples for these industries. The multiples are often skewed toward the higher end due to larger value deals with higher multiples. In general, lower middle market deals, that is, deals with transaction values less than \$50 million, tend not to be at the higher end of the range.

Industry by Activity - Deal Count - 12/31/2007									
Industry	Deal Count		Diff	52 Week Average		# Deals Reporting	24 Month Multiple		Low
	YTD 12/31/2007	YTD 12/31/2007		EBITDA Multiple	EBITDA		Hi	Low	
Aerospace, Aircraft & Defence	40	44	-4	N/A	N/A	N/A	N/A	N/A	
Agricultural Production	70	55	15	N/A	N/A	N/A	N/A	N/A	
Apparel	65	82	-17	13.90	6	20.02	6.67		
Automotive Products & Accessories	74	60	14	9.3	3	10.3	3.1		
Autos & Trucks	24	42	-18	N/A	N/A	N/A	N/A		
Banking & Finance	374	430	-56	N/A	N/A	N/A	N/A		
Beverages	63	61	2	N/A	N/A	N/A	N/A		
Broadcasting	145	540	-395	11.54	3	15.74	2.67		
Brokerage, Investment & Mgmt. Consulting	666	608	58	15.22	33	37.63	1.25		
Building Products	22	34	-12	N/A	N/A	N/A	N/A		
Chemicals, Paints & Coatings	203	220	-17	8.58	5	11.84	4.38		
Communications	237	247	-10	9.52	15	39.57	1.04		
Computer Software, Supplies & Services	1,594	1,688	-94	16.92	36	45.08	1.92		
Construction Contractors & Eng. Services	526	398	128	9.73	5	17.60	4.89		
Drugs, Medical Supplies & Equipment	367	374	-7	21.18	26	47.09	1.63		
Electric, Gas Water & Sanitary Services	192	218	-26	13.27	7	23.58	3.66		
Electrical Equipment	203	179	24	11.97	6	15.16	0.21		
Electronics	195	191	4	13.51	8	34.12	3.80		
Energy Services	121	148	-27	9.58	7	13.94	2.54		
Fabricated Metal Products	156	140	16	10.64	5	12.94	4.09		
Food Processing	138	162	-24	13.60	4	18.96	6.20		
Furniture	42	24	18	N/A	N/A	N/A	N/A		
Health Services	305	345	-40	11.48	11	16.74	4.49		
Household Goods	56	54	2	15.1	5	44.3	0.0		
Industrial & Farm Equipment & Machinery	184	221	-37	N/A	N/A	N/A	N/A		
Instruments & Photographic Equipment	145	163	-18	13.78	9	24.72	2.06		
Leisure & Entertainment	478	560	-82	13.94	21	40.54	1.89		
Miscellaneous Manufacturing	44	57	-13	12.58	3	15.05	10.77		
Miscellaneous Services	1,191	1,368	-177	14.17	16	26.42	0.05		
Office Equipment & Computer Hardware	76	72	4	10.56	5	24.54	4.58		
Oil & Gas	93	117	-24	15.64	4	28.53	5.15		
Packaging and Containers	13	18	-5	N/A	N/A	N/A	N/A		
Paper	61	76	-15	N/A	N/A	N/A	N/A		
Plastics & Rubber	94	106	-12	9.59	3	22.29	3.28		
Primary Metal Processing	97	116	-19	7.14	6	12.65	2.38		
Printing & Publishing	215	292	-77	18.12	6	31.39	5.05		
Real Estate	127	163	-36	17.7	5	31.39	5.05		
Retail	330	382	-52	11.74	15	33.45	4.16		
Stone, Clay & Glass	108	88	20	18.21	3	32.58	10.07		
Textiles	34	36	-2	N/A	N/A	N/A	N/A		
Timber & Forestry	30	34	-4	N/A	N/A	N/A	N/A		
Toiletries & Cosmetics	25	9	16	N/A	N/A	N/A	N/A		
Toys & Recreational Products	55	56	-1	11.45	3	16.00	6.24		
Transportation	150	150	0	14.62	6	45.85	2.20		
Valves, Pumps & Hydraulics	28	20	8	N/A	N/A	N/A	N/A		
Wholesale & Distribution	537	544	-7	13.45	43.49	16.28	1.86		
	<b>9,993</b>	<b>10,992</b>	<b>-999</b>						

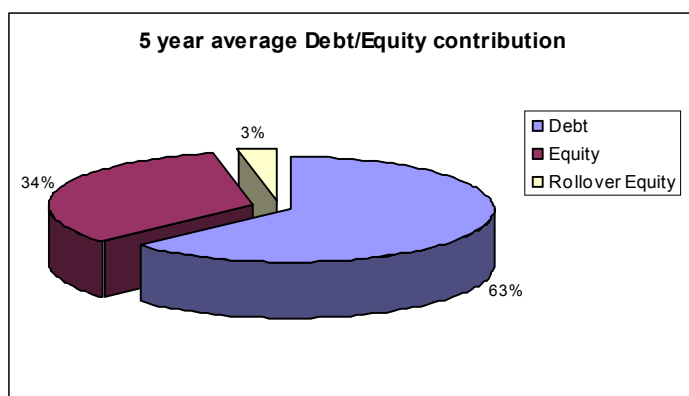
## Valuation, Deal Structure and Leading Middle Market Industries Statistics



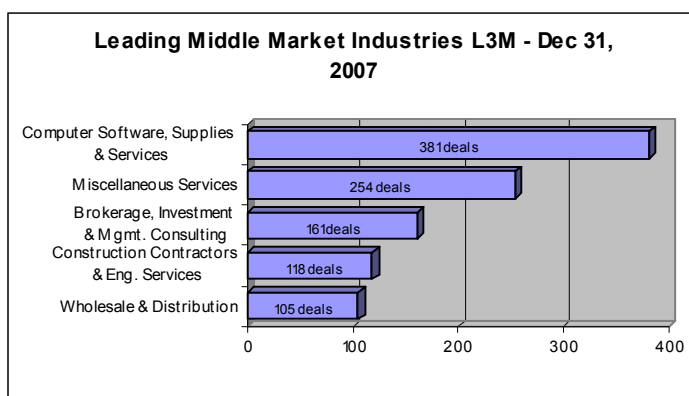
Source: FactSet MergerStat



Source: S&P



Source: Capital IQ



Source: FactSet MergerStat

## Current Economic Conditions and the Effect on Middle Market M&A Activity

Financial markets were off to a rocky start during the first three weeks of 2008. The following is a quick overview of events:

On January 4, 2008 a weaker-than-expected December jobs report added fuel to the recession fear fire. Employers added far fewer jobs in the month (net 18,000) than had been forecasted (net 70,000), while the unemployment rate shot up to 5%, which was a two-year high, according to the government report released around 8:30am on Friday, January 4th. The effect: a horrible day on Wall Street, the Dow Jones Industrial index average dropped almost 2%, the S&P 500 dropped almost 2.5% and the NASDAQ plummeted a whopping 3.8%.

On Monday January 21, 2008 chaos broke loose in international markets amid fears that a possible U.S. recession will cause a worldwide economic slowdown. International markets plummeted by 5% to 7% on average for the day (Nikkei down 5.7%, Shanghai down 7.2% etc.). The US markets followed international markets and opened down by almost 5% the next day.

On January 22, 2008, following an unscheduled meeting by the Federal Open Market Committee (“FOMC”), the Federal Reserve announced the biggest interest rate cut since October 1984—75 basis points, cutting the federal funds rate, which impacts how much consumers pay on credit card debt, home equity lines of credit and auto loans, to 3.5 percent from 4.25 percent. According to the statement released, the FOMC took this action in view of a weakening of the economic outlook and increasing downside risks to growth. The FOMC stated “while strains in short-term funding markets have eased somewhat, broader financial market conditions have continued to deteriorate and credit has tightened further for some businesses and households. Moreover, incoming information indicates a deepening of the housing contraction as well as some softening in labor markets.”

The hope is that the rate cut would restore some confidence in the financial markets and U.S. economy. In the coming months we will monitor the relevant M&A deal volume to learn how the latest economic conditions may impact the middle-market M&A environment for the remainder of 2008 and will continue to provide updates to our readers.

## Preparing Yourself for a Sale of the Business

All owners will exit their business at some point in time, whether through a transfer of ownership to family or management, or through a sale to an outside party. For most owners, this transition is the single most important event of their professional lives as it represents the culmination of many years of financial and emotional commitment. In our last newsletter, we briefly discussed the personal and company-specific concerns a seller should consider. In this article, we will explore in greater detail the personal concerns a seller should address before committing to what is a complex, and often lengthy, sales process.

At Elliott Davis Capital Partners our M&A practice focuses primarily on small and midsized businesses. While the size of these companies can vary widely, the one consistency they have is that they more often than not involve closely-held and family-owned businesses. The overwhelming majority of transactions (>80%) under \$100 million involve privately-held companies. With the first of nearly 80 million baby boomers turning 62 over the next several years, millions of family businesses will explore sale alternatives over the next decade. A recent Grant Thornton study found that as a result of baby boomers reaching retirement age, four in 10 businesses will change ownership in the next decade. More immediately, half of these businesses are expected to change hands over the next three to five years.

For this reason, the decision to start down the sales path is not something that should be taken lightly. This is not a decision that only impacts the individual owner/operator, but it has a dramatic effect on multiple other stakeholders including other owners, family members and employees, especially senior management. The continuity of the business is also something that needs to be considered, as a sale directly impacts customers, vendors and other advisors who may have a close relationship with the owner. Taking into consideration the impact a sale may have on all the stakeholders, the seller must establish both the personal and financial objectives which he is trying to accomplish. While price is important, fit and the continuity of the business are just as critical when considering the many options available.

A sale decision is one of personal financial diversification as the company is often an owner's largest financial asset, which generates most of his/her income and also makes up most of his/her net worth and anticipated dollars for retirement. A sale transaction is an opportunity to monetize the equity that has been built up over time in a business. When determining the financial objectives of the seller, it is best to sit down with a qualified financial advisor to help map out the appropriate financial plan. While creating a financial and wealth management plan usually does not appear to be an urgent matter, it is a very important matter that should be addressed in order to ensure a smooth transition, either through an outright sale to a third party, to the management team or a transition to the next generation in the family.

Business owners should work with their advisors to determine how much money they will need from a transaction to maintain their standard of living in retirement as well as cover larger expenses, such as educating children or grandchildren, larger charitable planning goals, and planned giving to family members and future generations. It is important to establish a financial goal where the proceeds from a sale are material enough to put some of this equity "in the bank" while maintaining a current income stream that is sufficient to maintain a desired lifestyle. A seller must then apply this financial requirement to relevant market valuations to determine if a sale or sale alternative will meet these requirements. The market price is independent of the individual seller's financial requirement, so it is critical that these valuations align in order to complete a successful transaction.

As discussed earlier, price is one of the factors but should never be the sole deciding factor, in selling a business. An owner should start identifying these non-financial objectives by planning what he intends to do after the sale is complete. Also, what is the desired outcome for other parties that will be affected by a sale? Will other family members who are currently involved in the business continue to do so? What role will the current management team have, and will they have an ownership position in the business going forward? The answers to these questions will have a greater impact on determining the appropriate sales process than valuation, as they determine who the likely buyer will be and what structure a sale will ultimately take.

The myriad of opportunities available to sellers can often be confusing. Accordingly, our approach involves careful evaluation of the alternatives first, including sale and other options. We do not accept an engagement with a predetermined recommendation. We focus on a seller's relationship with the family business, educate them on the options, and then work with them to implement a strategy that best meets their objectives. The most common assumption is that a sale to an outside party is the only viable option. However, a sale can take place to multiple types of buyers. Strategic, or corporate, buyers may make the most sense when trying to maximize the value of the business or ensure its continued viability following the owner's departure. Financial buyers, or private equity groups, offer a competitive price while enabling the company to maintain its independence, retain management and provide financial support for continued growth.

There are also sale alternatives that do not involve discussions with outside parties, such as management buyouts and leveraged Employee Stock Ownership Plans ("ESOPs"). These options provide the benefit of maintaining confidentiality and a reduced time table for completion while meeting many of the financial and non-financial objectives that are important to sellers. Often, one of these transactions can be completed in as little as 90 days with minimal disruption to the ongoing operations of the business. More importantly, they allow for a transition out of the business by the seller under his terms and at a pace with which he is comfortable.

Every business owner should plan for an exit, regardless of current circumstances, because there inevitably will be a transition. Advance preparation and control of the timing surrounding the transition are critical if the owner is to achieve the optimal outcome. Due to the many issues that affect the sale of a family-run business, it is important to remember that divesting a company is a process, not an event. This is a decision that should not be entered into until an owner is mentally prepared to do so, as a successful transition only occurs in numerous and well-coordinated steps. Please call on us at Elliott Davis Capital Partners to assist you in navigating these very important issues. Furthermore, through our affiliation with Elliott Davis Wealth Management, we have the capability to assist you in addressing transfer and estate planning issues, personal financial planning, investment management services and tax advisory services.

# ElliottDavis

## Capital Partners

### About us

Elliott Davis Capital Partners is a regional investment banking firm providing merger and acquisition, private placement, restructuring and corporate advisory services. We are focused on closely-held, mid-sized companies and their investors. For transactions involving these companies and their stakeholders, it is critical to bring investment banking, tax advisory and wealth management capabilities together as part of a single, cohesive team so that our client's objectives are met at the best possible terms.

Elliott Davis, one of the most respected professional service firms in the Southeast, complements our investment banking expertise and shares our commitment to client service.

The principals of Elliott Davis Capital Partners have transaction experience in a variety of industries including healthcare, manufacturing, distribution, retail, and information technology. Our experience ranges from start-up companies to public entities with enterprise values in excess of \$500 million. Depending on the service provided, Elliott Davis Capital Partners targets the following size transactions, but we will meet with any prospect regardless of industry or size to determine if we can be of service:

#### Merger & Acquisitions

- Assisting our clients with merger and acquisition services is at the heart of our practice and we specialize in transactions involving companies with enterprise values in excess of \$15 million

#### Private Placements

- Companies seeking to raise \$5 million or more in equity capital and/or raise or refinance \$10 million or more in debt or mezzanine capital.

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*"We understand the unique needs of closely held companies"*

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*"It is critical to bring investment banking, tax advisory and wealth management capabilities together as part of a single, cohesive team"*

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## Our Role as Your Investment Banker

Our role as Investment Banker can be summarized by the following categories:

- Provide M&A, Private Placement, Restructuring or Corporate Advisory Services  
We help position your company for a sale or private placement and will assist in the initial valuation of your company. As investment bankers we will also prepare the selling materials (Private Placement Memorandum, financial model, etc.) that will be provided to potential buyers or investors. As a team, Elliott Davis Capital Partners brings professional credibility to the process.
  - Maximize Management's Time and Focus  
The sale or private placement process is very demanding of management's time. As your banker we will take on much of this workload so that you, as management, can continue to focus on what you do best—running your business!
  - Introduce New Buyers or Investors and Maintain Confidentiality  
Often the eventual buyer or investor is unknown at the beginning of the sales or private placement process. As bankers we will present your company to a range of attractive buyers or investors. We do this in a very discreet and confidential way, therefore protecting the interests of your employees and clients/customers. As your banker we also require potential buyers or investors to reach the applicable agreements before sensitive information is released.
  - Drive the Sales Process, Negotiate and Evaluate Bids  
To maximize value for you and your company, we create a competitive atmosphere and prepare the appropriate timeline for the transaction. We manage potential acquirers or investors to ensure a timely close is achieved. In addition, we also negotiate the terms of the transaction on behalf of our clients and serve as a buffer ("the bad guy") in investor negotiations when appropriate.
  - Maximizes Value to the Seller  
Our primary goal is to maximize value through achieving the financial and non-financial objectives of the seller under the best possible terms.
-