

BDO CAPITAL M&A NEWSLETTER

Q3 2010 Middle Market Update



EXCESS LIQUIDITY AND SCARCITY PREMIUMS DRIVE M&A REBOUND

While many of us were focused on the mid-term elections and rebuilding business in the wake of the Great Recession, U.S. middle market* M&A activity continued to experience a strong rebound in Q3 2010. The raw data is compelling.

Middle market U.S. transaction volumes in Q3 2010 improved as the credit markets continued to ease and investor confidence returned. During the third quarter, completed deal volume in the middle market climbed a staggering 104% over Q3 2009 and total transaction values were up 15% over just the previous 90-day time frame. Underscoring the renewed market confidence is the fact that the average middle market transaction size grew to over \$92M, the largest average deal size since Q4 2007. Likewise, the M&A market as a whole showed renewed strength as the total number of domestic deals completed in the third quarter was up 20% over the same period in 2009. Some notable large transactions, such as Alcon's \$744M acquisition of LenSx Lasers and MedcoHealth Solutions' \$730M acquisition of United BioSource, led the way.

► Read more

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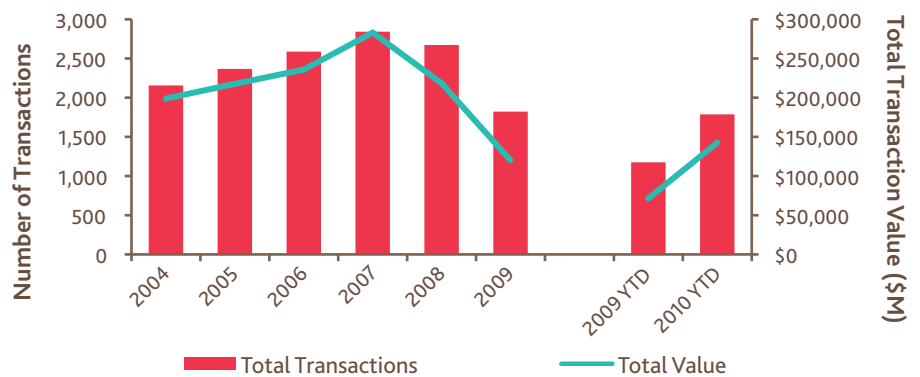
► GROWTH ACROSS THE BOARD

While many define the middle market as transactions up to \$750M in size, growth data can be distorted by a few large deals or a large increase in one "sector" of the market. Importantly, as seen in Figure 2, M&A activity has expanded for deals of all sizes within the middle market. From a volume perspective, the largest growth in sheer number of deals was in the lower end of the market, or deals sized at less than \$50M. However, when comparing 2010 YTD volume percentage increases with the same time period in 2009, the largest increase occurred in deals sized between \$250M and \$750M, which increased 138%, and deals sized between \$100M and \$250M increased 113%.

Why is this important? Confidence.

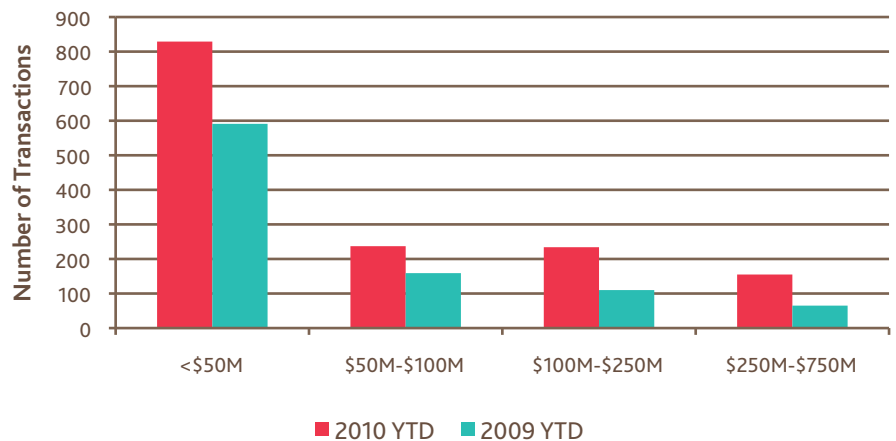
In the dark days of late 2008 and 2009, buyers would only pursue, and for that matter banks would normally only lend into, small "risk free" transactions. Now, however, buyers are looking up market and banks are looking to book loans, causing a "resurgence" in larger deals.

Figure 1: U.S. Middle Market M&A Activity



Source: Capital IQ

Figure 2: U.S. M&A Transactions by Deal Size¹

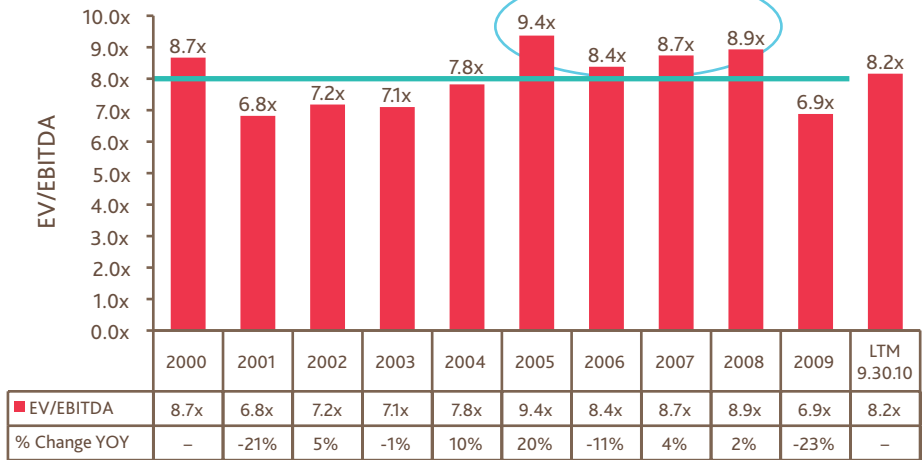


¹ Excludes deals with an enterprise value under \$10M
Source: Capital IQ

It is BDO Capital's view that what is truly driving the market is excess "equity liquidity" and also deal "scarcity premiums."



Figure 3: U.S. M&A Middle Market Transaction Multiples (<\$100 million)¹



¹ Includes multiples <20x
Source: Capital IQ

10-Year Average: 8.0x

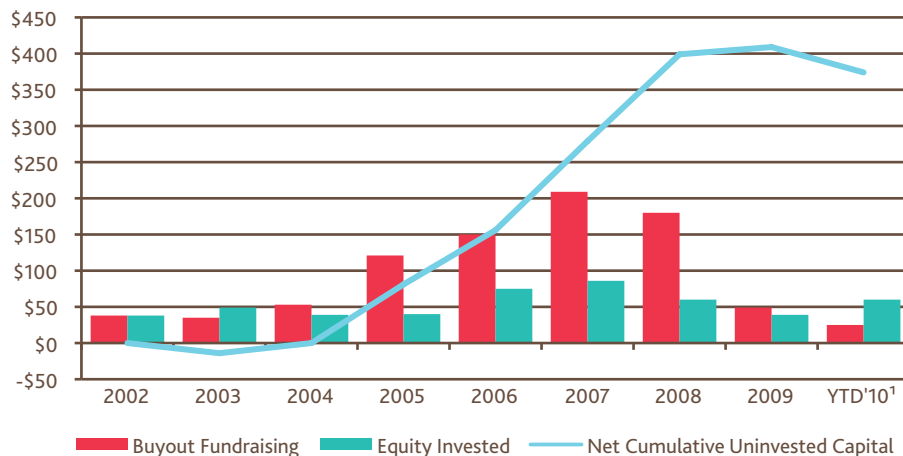
▶ A NICE REBOUND IN PRICING

With renewed confidence, and some bank debt in the system, valuations and multiples have escalated. The average reported EBITDA multiple for U.S. middle market deals (<\$100 million) was 8.2x for LTM 9/30/10, as seen in Figure 3. This multiple is significantly higher than the 10-year low of 6.8x in 2001 and is a more normalized multiple when benchmarked against the 10-year average multiple of 8.0x.

▶ EXCESS LIQUIDITY AND SCARCITY PREMIUMS FUEL UPTICK

It is BDO Capital's view that what is truly driving the market is excess "equity liquidity" and also deal "scarcity premiums." Let's look at each.

Figure 4: U.S. Buyout Fundraising vs. Equity Invested (\$ in billions)



¹ YTD through July 2010

Source: Thomson Reuters, includes U.S. Private Equity funds with a focus on buyouts, mezzanine, recaps and generalist

Excess "Equity Liquidity:"

Post Lehman Brothers, corporate America went through unprecedented downsizing trying to right size and hoard cash in fear that banks would call their loans or reduce their credit facilities. As earnings rebounded and staffing did not correspondingly increase, corporate cash and liquidity exploded. At last count, nonfinancial public companies were sitting on \$1.8 trillion in cash and liquid investments, up 26% YOY. Putting this into further historical perspective, cash now makes up about 7% of all company assets – the highest amount since 1963.

In addition, as seen in Figure 4, Private Equity (PE) firms raised unprecedented amounts of



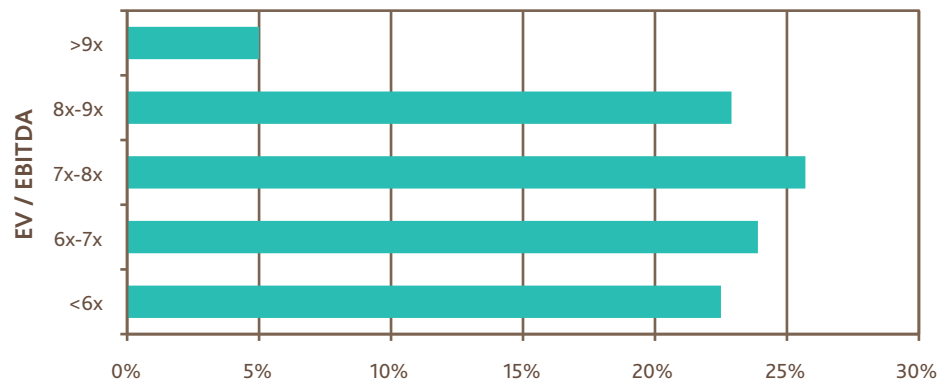
Transaction multiples for strong companies are at similar levels to what we have seen in the most robust markets.

capital during the robust years from 2005 to early 2008. Equally important, buyouts effectively stopped during the approximate two-year period starting in late 2008 to 2009. With an average fund life of five to seven years, PE firms sat on the sidelines during that recent tumultuous period focusing more on existing portfolio companies than on making new investments. These buyout firms now have about \$400 billion of equity to invest. That equity coupled with moderate leverage means that PE firms have purchasing power of approximately \$1.4 trillion, rivaling that of their strategic competitors.

"Scarcity Premiums:"

With so much equity liquidity looking for a home, and sellers only now starting to show good earnings and prospects, there is a scarcity of good companies to buy. Still a bit leery that the economic rebound could dissipate, buyers are looking for companies with records of strong performance during the recession and, with large amounts of cash to deploy, buyers are willing to pay up. We have seen this in a number of transactions that we are working on and the data seen in Figure 5 is, in our experience, playing out in today's market. Transaction multiples for strong companies are at similar levels to what we have seen in the most robust markets. It is not uncommon for some of our clients that have performed well in the recession to see the number of offers they receive approaching double digits at unusually high valuation multiples.

Figure 5: Q4'10 Projected Average Purchase Price Multiple For Middle Market LBOs



Source: Thomson Reuters LoanConnector Poll – Percentage of Respondents

The conclusions are compelling.

We have seen a rebound across the board in terms of M&A volumes and deal sizes. However, unlike the go-go days of 2005-2008, this market rise is being driven by excess equity liquidity as opposed to too much bank leverage. We would expect this market phenomenon to last until the capital is deployed (approximately 6-12 months) or until it is replaced by bank liquidity – potentially a more perilous event.

We at BDO Capital have a long background of assisting owners of middle market companies in exploring their strategic liquidity alternatives. We would welcome the opportunity to assist you in these or other capital markets needs.

► RECENT NOTABLE U.S. MIDDLE MARKET TRANSACTIONS

Close Date	Acquirer(s)	Target	Target Description	Industry	Enterprise Value (\$M)	EV/ Revenue	EV/ EBITDA
10/07/10	Bristol-Myers Squibb Company (NYSE:BMJ)	ZymoGenetics, Inc.	Develops and commercializes therapeutic proteins for the treatment of human diseases	Biotechnology	\$732.8	4.5x	-
09/17/10	MedcoHealth Solutions Inc. (NYSE:MHS)	United BioSource Corporation	Provides evidence-based solutions to support the development and commercialization of pharmaceuticals, biotechnology, and medical devices	Life Sciences Tools and Services	\$730.0	-	-
08/23/10	Alcon Inc. (NYSE:ACL)	LenSx Lasers, Inc.	Manufactures cataract surgery lasers that operate inside the eye for cataract removal	Healthcare Equipment	\$744.0	-	-
08/17/10	Cott Corporation (TSX:BCB)	Cliffstar Corporation	Manufactures, sells and distributes non-alcoholic beverages, primarily private-label shelf-stable juices	Packaged Foods and Meats	\$667.6	1.0x	6.9x
08/12/10	The GEO Group, Inc. (NYSE:GEO)	Cornell Companies Inc.	Provides correctional, detention, rehabilitation, and treatment services outsourced by federal, state, county, and local government agencies	Security Services	\$660.7	1.6x	7.8x
08/11/10	Oracle Corp. (NasdaqGS:ORCL)	Phase Forward Inc.	Provides an integrated clinical research suite of enterprise-level software products, services, and hosted solutions	Healthcare Technology	\$591.1	2.7x	19.5x
08/03/10	ITT Corporation (NYSE:ITT)	Godwin Pumps of America, Inc.	Manufactures and supplies automatic self-priming pumps	Industrial Machinery	\$585.0	2.9x	-
07/06/10	Avnet Inc. (NYSE:AVT)	Bell Microproducts Inc.	Distributes storage products and systems and computer products and peripherals to OEMs, VARs and dealers	Technology Distributors	\$592.8	0.2x	10.9x
07/01/10	QBE Insurance Group Ltd. (ASX:QBE)	NAU Country Insurance Company	Provides crop insurance solutions for farmers	Property and Casualty Insurance	\$666.0	1.9x	-
07/01/10	CCMP Capital Advisors, LLC	Infogroup	Provides business and consumer databases for sales leads, mailing lists, direct marketing, database marketing, e-mail marketing, and marketing research solutions	Data Processing and Outsourced Services	\$637.4	1.3x	7.5x
06/11/10	Cincinnati Bell Technology Solutions Inc.	Cyrus Networks LLC	Provides corporate colocation and data center services	Internet Software and Services	\$644.0	9.9x	17.9x
06/01/10	Oak Hill Capital Partners	Dave & Buster's Holdings, Inc.	Owns and operates restaurants and entertainment complexes	Restaurants	\$570.0	1.1x	-
03/31/10	Diamond Foods, Inc. (NasdaqGS:DMND)	Kettle Foods, Inc.	Engages in the production and sale of snack foods	Packaged Foods and Meats	\$650.0	2.6x	15.2x

ABOUT KENNETH A. CSAPLAR

Mr. Csaplar serves as President and Managing Director of BDO Capital Advisors, LLC (formerly Trenwith Securities, LLC). Before founding BDO Capital's Boston office, Mr. Csaplar co-managed Arthur Andersen's New England Corporate Finance Group. Prior to joining Andersen, he founded and ran Fleet Financial Group's mergers and acquisitions division and was responsible for sourcing and closing transactions in Fleet's eight-state geographical footprint. While at Fleet, Mr. Csaplar's primary focus was working with and advising owners of privately owned middle-market companies implementing liquidity events including sell-side transactions, leveraged recapitalizations, ESOPs, special dividends and capital raises.

Prior to joining Fleet, Mr. Csaplar was employed at Brown Brothers Harriman & Co. (BBH & Co.) overseeing the Boston office's corporate finance activities. During his 13 year tenure at BBH & Co., he negotiated and closed mergers and acquisitions transactions, including stock and asset sales of middle market and closely held public companies. In addition to his corporate finance skill sets, Mr. Csaplar has valued corporate common and preferred stock, been a panelist in numerous seminars and has sat on the board of directors of a number of public and private companies.

Before joining BBH & Co., Mr. Csaplar was employed as an investment banker at Lepercq Capital Corp. in New York City structuring sale lease-back transactions for large real estate projects with equity interests sold through Drexel Burnham Lambert, Merrill Lynch Capital and Paine Webber Securities.

Mr. Csaplar received an M.B.A. from Cornell University, an M.S. in Taxation from Bentley College, and a B.A. from the University of Pennsylvania. He is qualified as a General Securities Representative and a General Securities Principal.

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