

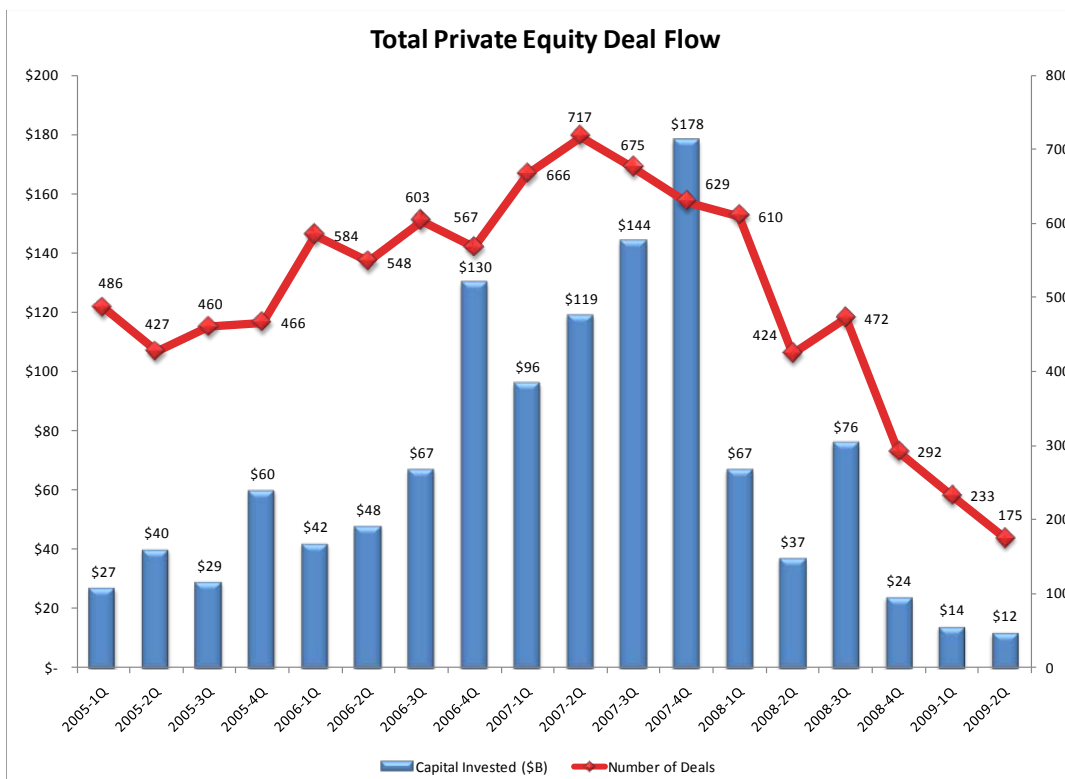
Capital Transactions

The Road to Recovery

By Aaron Zeide, *Elliott Davis Capital Partners*

Although talk of “glimmers of hope” and “green shoots” has died down somewhat since the first quarter of 2009, market participants found reasons for cautious optimism. The United States, Canada, Mexico, and Great Britain all reported either smaller than expected declines or outright growth. All the usual leading and concurrent indicators showed improvement, most notably a resilient stock market. However, concerns over inflation, unemployment, and the unavailability of capital may continue to depress a recovery. Treasury Inflation-Protected Securities (TIPS), which are typically used to hedge portfolios against the effects of inflation, are especially in demand now that retail investors’ portfolios are increasingly concentrated in fixed-income securities. Some economists see this as a worrying sign which may preemptively increase inflationary pressures on consumers.

Dealmakers remained on the sidelines during the first half of 2009, as the economic situation in North America and around the globe remained uncertain. In addition, a lack of liquidity from traditional bank and non-bank lenders chilled the market’s willingness and undercut its ability to make investments and undertake merger activity (see Figure 1).



Source: PitchBook Platform

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Continued from previous page...

Figure 1. Total private equity deal flow in terms of cash and capital invested from Jan 2005 to June 2009.

Even as deals became fewer and farther between, the relative proportion of deals consummated in the lower middle market (under \$50M) increased substantially. Market observers noted that two elements factored in to this shift: lower valuation multiples in small deals, which consequently require less debt as a percentage of the deal, and a concerted effort on the part of private equity and strategic buyers to diversify their portfolio of acquisitions (see Figure 2).

While private equity investors are ratcheting back on the deployment of funds raised, the cumulative total “overhang,” a term used to describe the gaps between funds raised and equity invested, widened to \$400 billion through April 2009 (see Figure 3).

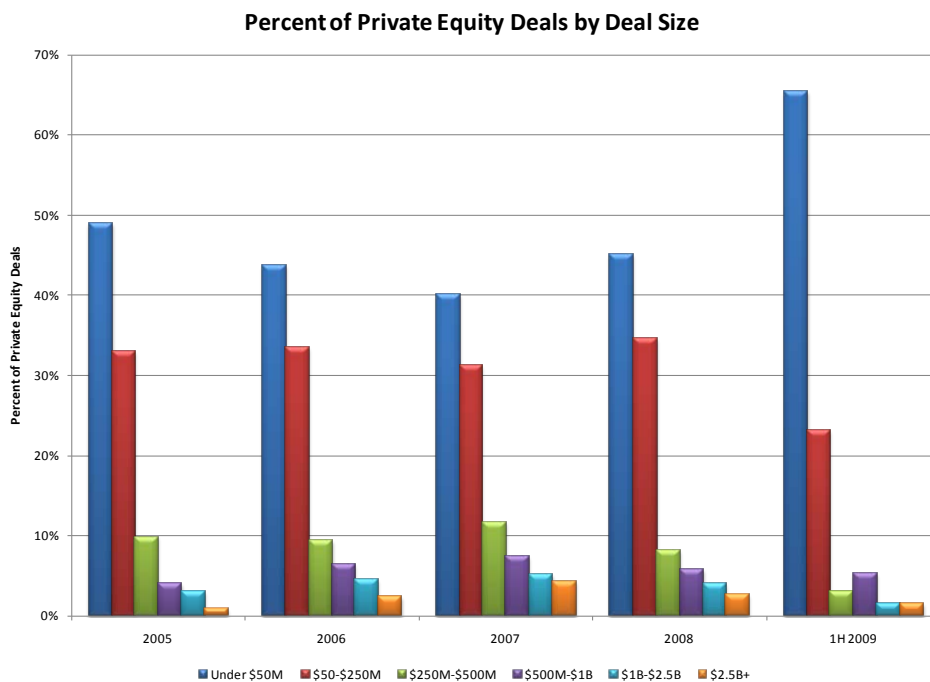


Figure 2. Percent of private equity deals by deal size from 2005 to June 2009. Note the relative percentage increase in deals under \$50M. Source: PitchBook Platform

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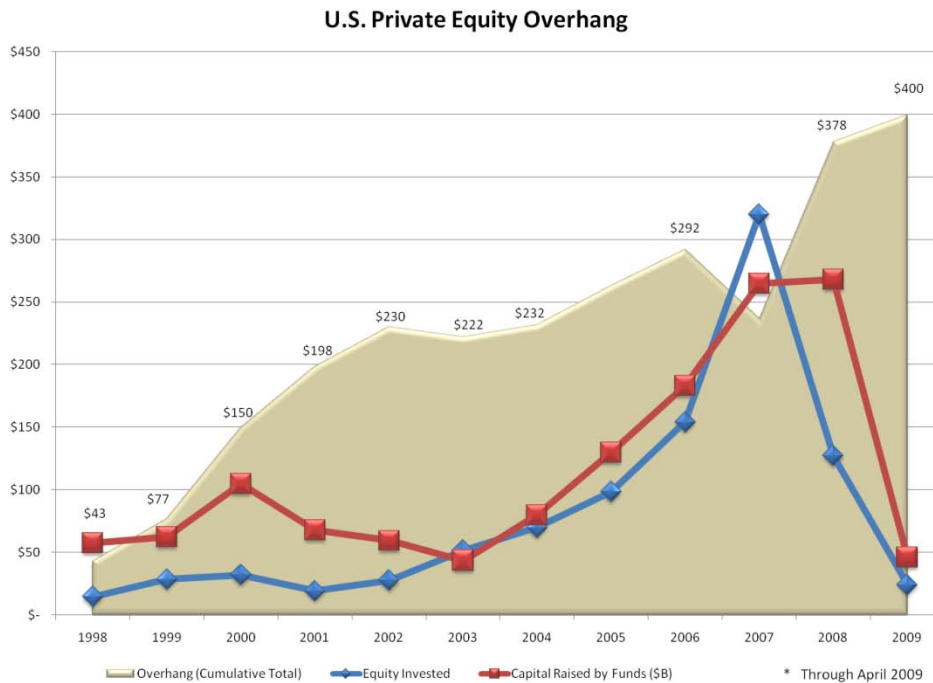


Figure 3. U.S. Cumulative Total Private Equity Overhang 1998 to April 2009. Source: Pitchbook Platform

Across the 10 main industry sectors shown in Figure 4, below, the number and value of strategic M&A and leveraged buyout deals increased through 2007, and has decreased in the two years ending June 30, 2009. The number of deals, but not the total value, is back up to 2005 levels.

North American Target M&A

(As of 6/30/2009)

Last Twelve Months Ending June 30 of:

Sector	2005		2006		2007		2008		2009	
	# of Deals	Value (\$mil)	# of Deals	Value (\$mil)	# of Deals	Value (\$mil)	# of Deals	Value (\$mil)	# of Deals	Value (\$mil)
Consumer Discretionary	2,009	\$ 204,193	2,218	\$ 169,795	2,815	\$ 323,839	2,391	\$ 93,759	1,679	\$ 45,347
Consumer Staples	337	79,077	369	43,083	471	41,797	408	109,657	330	27,891
Energy	637	89,088	846	190,299	926	141,519	775	127,267	656	70,126
Financials	1,138	174,644	1,280	230,574	1,480	359,745	1,391	146,732	1,895	164,978
Healthcare	813	57,690	1,029	141,193	1,087	184,759	1,092	117,383	851	235,964
Industrials	1,491	71,110	1,865	83,161	2,239	115,674	2,118	122,188	1,500	25,872
Information Technology	1,930	87,814	2,190	110,175	2,282	192,780	2,206	116,279	1,563	52,808
Materials	654	47,584	942	125,093	1,249	165,602	1,058	149,969	909	64,718
Telecommunication Services	196	104,991	164	130,092	163	42,226	163	41,480	111	20,264
Utilities	143	49,856	169	42,121	224	88,570	171	25,883	152	14,684
Grand Total	9,348	\$ 966,047	11,072	\$ 1,265,586	12,936	\$ 1,656,511	11,773	\$ 1,050,597	9,646	\$ 722,652

Source: Capital IQ Market Observations. July 2009.

* Total of strategic M&A and leveraged buyouts

Figure 4. North American target M&A. This figure shows the trend in number of deals and value by year.

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During the same period, valuation multiples decreased across all ten industry sectors for both large (>\$500M) and small (<\$500M) transactions, but only slightly.

Median Implied Enterprise Value / EBITDA (North American Targets)								
(As of 6/30/2009)								
Sector	Last Twelve Months Ending June 30 of:							
	2006		2007		2008		2009	
	Less Than \$500M	Greater Than \$500M	Less Than \$500M	Greater Than \$500M	Less Than \$500M	Greater Than \$500M	Less Than \$500M	Greater Than \$500M
Consumer Discretionary	10.2x	11.2x	9.9x	11.9x	9.9x	9.9x	9.0x	6.7x
Consumer Staples	8.2x	11.3x	10.8x	11.6x	8.0x	12.3x	7.6x	9.8x
Energy	7.9x	10.1x	8.5x	9.5x	6.1x	10.8x	5.1x	9.6x
Financials	N/M	N/M	N/M	N/M	N/M	N/M	N/M	N/M
Healthcare	11.9x	16.2x	14.9x	17.0x	15.3x	15.9x	9.3x	12.7x
Industrials	9.0x	10.1x	6.7x	11.9x	9.9x	10.9x	10.8x	13.2x
Information Technology	13.1x	15.6x	12.8x	16.0x	16.4x	17.2x	9.4x	12.3x
Materials	6.7x	9.2x	8.0x	10.0x	10.1x	8.6x	7.2x	8.4x
Telecommunication Services	9.5x	10.5x	7.6x	10.2x	8.1x	13.6x	8.1x	7.3x
Utilities	6.1x	12.4x	18.5x	9.9x	11.2x	9.4x	6.4x	11.5x

Source: Capital IQ Market Observations. July 2009.

Figure 5. Valuation multiples for the twelve months ending June 30.

During the same period, valuation multiples decreased across all ten industry sectors for both large (>\$500M) and small (<\$500M) transactions, but only slightly.

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