

“ a firm belief in the entrepreneurial spirit ”

CLEARY GULL

MARKET MONITOR

M&A UPDATE



1ST QUARTER 2010

THE RECOVERY HAS REACHED THE MIDDLE MARKET!

Transaction Volume is Rebounding

During the fourth quarter of 2009, the total number of U.S. lower middle market M&A transactions (enterprise values between \$10 million and \$250 million) increased for the third consecutive quarter. The number of transactions in the most recent quarter increased to 378, 30% higher than the previous period and 63% higher than Q1 of 2009. However, volume is still 32% below the level achieved during Q2 of 2007.

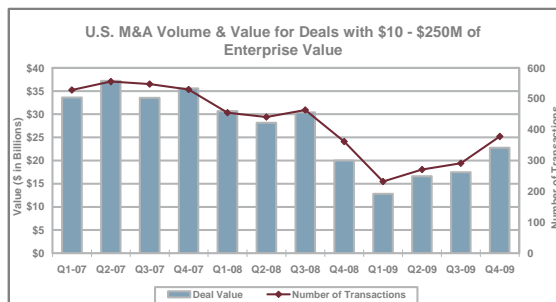
A number of factors have contributed to a return in deal volume including: stable to improving corporate profitability, credit markets beginning to loosen and financing costs starting to come down (could they have gotten any higher?), generally lower commodity costs and volatility, a slowly strengthening economy, and a more positive economic outlook.

Time Marches On

Private equity funds, by the nature of their structures, typically need to sell all of their companies within 10-12 years after the funds are formed and usually expect to sell each company approximately five years after making their initial investment. Due to the limited exit opportunities over the past 12-24 months and a record number of private equity investments between 2004 and 2006, we believe funds will face increasing pressure to monetize their investments.

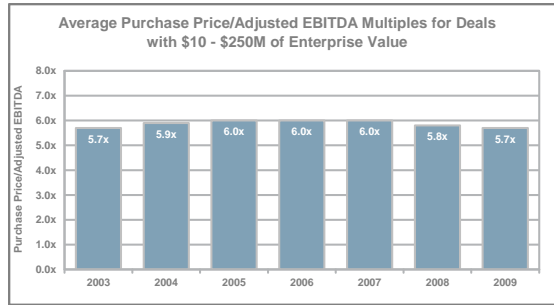
Timing for the sale of many privately-owned businesses is driven by the age and retirement plans of their owners. With time marching on, and tax rates increasing (which we will talk about later in this Market Monitor), we expect many owners to explore a sale transaction in 2010.

DEAL VOLUME REBOUNDING



Source: Thomson Financial

PURCHASE PRICES AND LEVERAGE ARE DOWN, BUT NOT OUT



Source: GF Data Resources

Multiples Return to Historic Averages

During all of 2009, the average EBITDA purchase price multiple for lower middle market leveraged buyout transactions was 5.7x EBITDA compared to 5.8x EBITDA in 2008. However, the average EBITDA multiple in the second half of 2009 was only 5.2x.

Some have argued the decline in multiples in the second half of 2009 was due to an increased percentage of companies sold generating “average” or “below average” growth and profitability compared to prior periods. It would come as no surprise that companies with lower growth and profitability received lower valuations.

Speaking of averages, the average EBITDA multiple for lower middle market companies sold from 2003 to 2009 was 5.9x, which is not materially different than the averages in 2008 and 2009.

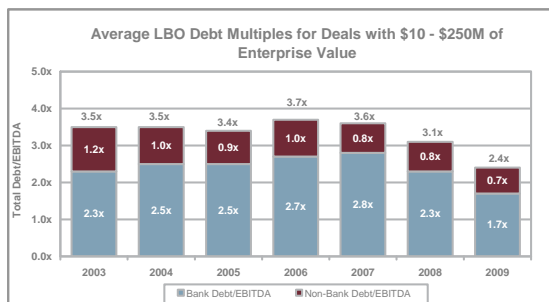
LBO Financing – Available but “Quantities are Limited”

Average Total Debt/EBITDA multiples declined by 0.7x from 2008, to 2.4x during 2009. The decline is almost entirely explained by a 0.6x decline in Senior Debt/EBITDA from 2.3x in 2008 to 1.7x EBITDA in 2009.

Nonetheless, lenders’ appetite for “clean transactions” has increased and pricing on these financings has dropped dramatically. For stable companies, pricing is as low as LIBOR + 225-300 basis points, with no LIBOR floors. As the recovery continues, we expect lending ratios to approximate 2008 levels, but remain below the 2006/2007 highs.

Pricing for mezzanine debt remains in the 16-20% range, a record spread above senior debt levels. Now more than ever, it is important for owners to competitively shop senior and mezzanine debt providers to optimize their cost of capital.

DEBT MULTIPLES CONTRACT



Source: GF Data Resources

UNCLE SAM IS GOING TO TAKE MORE OF THE PIE: THE ONLY QUESTION IS, HOW MUCH?

2010	
Federal Tax Brackets	Capital Gains Long Term Effective Tax Rate
10%	0%
15%	
25%	15%
28%	
33%	
35%	

Estimated 2011	
Federal Tax Brackets	Capital Gains Long Term Effective Tax Rate
10%	10%
15%	
25%	20%
28%	
36%	
39.6%	25.4%

Taxes Are Increasing

When the Bush tax cuts expire at the end of 2010, U.S. capital gains taxes will increase from 15% to 20%. Although passage is uncertain, House Democrats have also proposed a 5.4% surcharge on capital gains for high earners to help pay for health care reform. Together, capital gains taxes could increase from 15% to 25.4% in 2011.

Additionally, the top ordinary income bracket is projected to rise from 35% to 39.6% in 2011. State budget deficits are likely to cause state tax increases as well, but those proposals are less developed at this time.

Although taxes alone are never a justification for a transaction, it is essential to look at tax treatment and after tax proceeds. An approximately 13% change in the top federal tax rate and up to 69% change in long-term capital gains rate is significant!

If business owners are interested in closing a transaction before year-end to assure the lower tax rates, they should begin the process by April or May at the latest. A sale process typically takes six to nine months. Beginning a process in this time frame should provide sufficient time to close a deal before year-end and avoid the higher tax bill.

Budget Deficits Cannot be Ignored

The Congressional Budget Office currently estimates a deficit of \$1.3 trillion for fiscal year 2010. This deficit is on top of a \$1.4 trillion deficit in 2009. The 2009 and 2010 deficits are the largest since World War II.

Our federal and state deficits, and our national debt which stands at approximately \$12.4 trillion, are issues which must be addressed.

The best way to “fix” the problem would be to accelerate economic growth. However, most economists do not believe we could generate sufficient growth to reverse current trends.

It is likely that any real solution will require both increased taxes and decreased spending at both the federal and state levels.

However, the longer we defer a real solution, the greater the risks become. Higher inflation and increased taxes seem inevitable. The question is, when and how much?

Our fiscal issues are clearly another reason that business owners who are considering a sale in the next several years might accelerate their plans. The risk of a financial shock due to poor public sector fiscal discipline is real and increasing each day.

FIRM OVERVIEW

Cleary Gull Inc. is an employee-owned firm providing specialized financial services since 1987 to individuals, institutional investors, and middle market companies through two operating divisions: Investment Banking and Investment Management Services. “A Firm Belief in the Entrepreneurial Spirit” is our core ideology and the foundation for all of our client engagements.

Cleary Gull’s investment bankers help our clients achieve their financial and business goals with advice on exclusive sales, mergers, acquisitions, raising debt and equity in private capital markets and other transactions, working through complex financial, legal, tax, accounting and other technical issues, and delivering superior results.

GLOBAL REACH

Cleary Gull is a member of the International Association of Investment Bankers. The IAIB (www.iaib.org) is an affiliation of investment banking firms from Europe, North America and South America working together to broaden their reach and leverage their expertise.



International Association
of Investment Bankers

CONTACT

The Cleary Gull Investment Banking team has completed more than 120 transactions since 1995, representing approximately \$6 billion in transaction value. We are dedicated to providing unbiased, conflict-free advice to middle market companies.

Contact us for more information on Cleary Gull and our Investment Banking services.

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