

32% of distributors said they were on the acquisition trail in 2008 compared to 37 percent in 2007, according to ID's 62nd Annual Survey of Distributor Operations.



Multiple forces alter M&A landscape

Lower multiples and tight credit markets continue to plague industry M&A activity

ENTERPRISE VALUES for industrial distribution companies are falling, a factor that continues to plague the industry's merger and acquisition landscape.

The adjusted mean and median "last twelve month" (LTM) EBITDA multiples of the Lincoln International Industrial Distribution Index (LI IDI), for example, stood at 5.4x and 5.3x respectively as of February 27. That's down about 35 percent compared to six months ago and 11 percent compared to the end of 2008.

The combined market capitalization of the LI IDI comparable company index (shown in the table below) has fallen roughly \$21 billion, or 51 percent, since its peak of \$41.9 billion in October 2007. What's more, valuations in the industrial

distribution sector have not escaped broader market multiple contraction following a consistent string of bad news regarding GDP, the ISM Purchasing Managers Index, durable goods orders, construction starts, employment and consumer confidence.

M&A transaction volume and transaction value further declined in the fourth quarter of 2008 as a result of the lack of financing availability, poor current and forecasted earnings performance, increased near-term pessimism and a general "bunker mentality" that kept even well-capitalized strategic buyers focused on running their own businesses. Middle market M&A transaction volume (those between \$10 million and \$250

million) fell 31 percent year-over-year and 15 percent versus the preceding third quarter of 2008. Initial data for January suggested the trend continued.

Looking ahead, M&A activity should begin to benefit from the credit markets' strides toward stabilization. However, average debt multiples remain down meaningfully compared to a year ago. Standard & Poor's reported that total average debt multiples for middle market leveraged buyout transactions (LBOs) fell to less than 3x during the fourth quarter compared to a peak of more than 6x in 2007.

Reduced-leverage multiples will continue to provide an advantage to well-capitalized strategic buyers or private equity buyers

willing to finance an acquisition with a much larger equity contribution. This will put a larger amount of their own invested capital at risk and result in a more challenging internal rate of return calculation.

In general, buyers must contribute greater amounts of equity to complete LBOs these days. As Standard & Poor's also recently reported, the equity component of LBO transactions involving targets with less than \$50 million in EBITDA increased to 43 percent in 2008 from 33 percent in 2007.

Curt Tatham is a director at Lincoln International, which specializes in merger and acquisition services, debt advisory services and valuations for companies involved in middle-market transactions. He can be reached at 312-580-8329 or ctatham@lincolnternational.com.

INDUSTRIAL DISTRIBUTION INDEX: VALUATION UPDATE

Company Name	Market Cap	Enterprise Value	Enterprise Value / LTM EBITDA as of				Stock Price	% of 52 Week High
			8/31/08	10/30/08	12/29/08	2/27/09		
Airgas Inc.	\$2,504	\$4,335	9.1x	6.5x	6.6x	5.7x	\$30.79	47.00%
Anixter International Inc.	1,038	2,140	7.3x	4.7x	4.2x	5.0x	29.41	39.20%
Applied Industrial Technologies, Inc.	680	770	6.9x	5.3x	5.0x	4.8x	16.12	50.10%
Barnes Group Inc.	488	960	7.6x	5.2x	4.9x	4.4x	9.32	28.80%
DXP Enterprises Inc.	147	316	9.7x	5.0x	6.3x	5.7x	11.41	33.40%
Fastenal Co.	4,474	4,387	16.5x	12.2x	9.9x	9.0x	30.12	53.30%
Houston Wire & Cable Company	105	49	7.1x	5.0x	4.5x	3.2x	5.95	26.20%
Interline Brands Inc.	258	599	7.1x	5.6x	5.8x	5.5x	7.94	38.70%
Kaman Corp.	299	385	11.0x	8.0x	6.5x	4.5x	11.72	34.60%
Lawson Products Inc.	151	155	6.0x	5.3x	4.5x	3.8x	17.77	46.20%
MSC Industrial Direct Co. Inc.	1,905	2,040	9.6x	6.9x	6.6x	5.9x	30.59	56.00%
Rexel SA	1,421	5,128	8.2x	6.8x	6.0x	5.7x	5.56	35.90%
United Stationers Inc.	515	1,168	6.6x	4.7x	4.7x	4.8x	21.73	40.50%
W.W. Grainger, Inc.	4,952	5,086	8.4x	6.6x	6.4x	5.7x	66.16	70.40%
Watsco Inc.	978	958	12.7x	10.4x	9.9x	9.1x	34.33	56.20%
WESCO International Inc.	701	1,754	6.8x	4.7x	4.5x	4.7x	16.6	35.70%
Adjusted Mean(1)			8.4x	6.1x	5.9x	5.4x		42.60%
Median			7.9x	5.4x	5.9x	5.3x		39.90%