Lincoln INTERNATIONAL

DEALREADER | Private Company Group

The merger-and-acquisition newsletter for owners of private companies and their advisors

April / May 2013

Inside this Issue

Welcome to the April / May 2013 issue of the Private Company Group DealReader, a newsletter focused on merger-and-acquisition trends, transactions and events of interest to owners of private companies and their advisors.

In this issue, we pose five questions to Dan Pansing of Chicago-based private equity firm Merit Capital Partners. Mr. Pansing discusses how a recapitalization can benefit private company owners' specific liquidity needs. His interview provides an overview of recapitalizations and explains how such a transaction can provide partial liquidity to owners without sacrificing control and longer term upside.

Other topics covered in this issue include:

- An introduction to Lincoln International's new Beijing office and its CEO, Joe Chang.
- The Lincoln 300 Index and a discussion of our unique perspective on the middle market
- Key M&A market and purchase agreement statistics
- Profiles of recent Lincoln International transactions, including the sale of Continental Industries, Inc. to Hubbell Incorporated

We hope you find this newsletter a useful tool, and we welcome your comments and questions.

Lincoln International

Five Questions For: Dan Pansing, Merit Capital Partners - Recapitalizations

Dan Pansing, Managing Director at Merit Capital Partners

Chicago-based Merit Capital Partners manages over $1.7 billion of capital through five institutionally sponsored limited partnerships. Merit invests subordinated debt and equity capital in middle-market companies principally in manufacturing, distribution and services industries. Investing steadily since 1993, Merit has completed 70 platform investments, nearly half of which have been recapitalizations.

Dan Pansing, a Managing Director at Merit, joined the firm in 1999 and had previously worked as a commercial loan officer at LaSalle Bank (now Bank of America) focused on leveraged and asset -based transactions involving privately held middle market companies.

We asked Mr. Pansing five questions regarding recapitalizations and how private company owners can utilize recapitalizations to serve their liquidity needs.

Q: What is a recapitalization?

A: Often, a private business owner's desire for liquidity does not equate to a desire to sell his business. Recapitalizations ("recaps") allow owners to achieve their liquidity goals even as they continue to own and operate their businesses. Recaps utilize leverage, often beyond just senior debt, to accomplish a transaction without requiring a sale process. Depending on the owner's goals, he can retain either majority or minority ownership.

Q: What are typical considerations for an owner considering a recap?

A: By choosing a recap, business owners give themselves two key options beyond the opportunity to generate meaningful liquidity. First, they get the opportunity to choose the type of partner they would like, tailoring the selection of a new partner to include specific types of strategic, financial or industry expertise. Second, and most significantly, the selling shareholders can achieve partial liquidity but maintain ownership such that they are able to remain active in their businesses and participate in a "second bite of the apple" at some point in the future. This "second bite" option is especially valuable in softer M&A markets where a full sale of a company might not bring the same valuation it previously would have or may at some point in the future.

"Recapitalizations allow owners to achieve their liquidity goals even as they continue to own and operate their businesses."

MERIT CAPITAL PARTNERS

Q: In what types of situations do private owners use recaps?

A: Recaps can be used in a number of situations where private owners seek liquidity, including to satisfy lifestyle requirements, succession planning, estate planning and risk sharing situations, as well as generational transitions and divorces. Recapitalizations can also be useful when shareholders have disparate goals, such as expansion vs. status quo.

Merit has provided capital in transactions similar to each of the following examples with very favorable outcomes for the shareholders, managers and companies as a whole.

<u>Wealth diversification scenario:</u> Owner-managers may be seeking liquidity for wealth diversification and capital to take their business to the next level. Through a recap, managers can receive liquidity to diversify their wealth, but maintain active roles in the business and meaningful ownership stakes going forward. In addition, the owner-managers will have the opportunity to reap additional upside from a future sale or recap.

(Continued on page 2)

(Merit Capital, continued from page 1)

Outside shareholder buy-out scenario: Management of a company may own a small portion of the business and has the opportunity to buy out the majority owners. Through a recap, management can buy out the outside shareholders and increase its ownership stake in the company. In addition, the management-owners will have the opportunity to participate in a sale or recap at some point in the future.

Active vs. inactive siblings scenario: An active sibling may want to buy out his inactive siblings in a family-owned business. Through a recap, the active sibling is able to increase ownership, take a cash distribution and remain active in the company, while liquidity is achieved for the inactive siblings. In addition, the active sibling will have an opportunity for a "second bite" at some point in the future.

Q: How does a recap differ from other options available to a private company owner?

A: A recapitalization differs from other liquidity-generating transactions primarily in its flexibility. While an outright sale to a strategic or financial acquirer will likely obtain greater liquidity and a higher *immediate* valuation, these transactions often do so at the cost of the owners' control of the company and future upside potential. In a recap, owners can realize partial liquidity, maintain significant upside potential and retain significant ownership and control of the company's future direction. Additionally, outside investors in a recap can often help accelerate the company's growth with their experience.

Q: What happens after a recap?

A: There is no set playbook for what happens immediately following the completion of a recap transaction. How things go depends on who the new investor is and the role they plan to play at the company. At Merit Capital, we generally join a company's board of directors, and contribute our expertise and experience when it comes to formulating the growth or operating strategy, identifying and executing acquisitions, effecting divestitures and managing capital allocation. We intend to provide value in these areas, while leaving the day-to-day operations to be handled by the incumbent management team, supporting the tenet that a key attribute of a good recap candidate is to have good management.

Following the new partner's investment period, generally five to seven years, the recap partner will seek to exit its investment in the company. One option is an outright sale, in which all shareholders participate together in a marketing process which is likely to result in the company being sold to a strategic acquirer or to a traditional control-oriented private equity firm. Another involves management and other existing shareholders undertaking a second recap transaction, raising capital to repay the financial partner's remaining debt and repurchase its equity. This subsequent recap is possible because the debt used in the initial recap generally has been paid down over the investment period. Hopefully, the company has grown during this period as well, increasing its overall debt capacity. As a result, the company can remain solely in the hands of the remaining shareholders for many more years – or at least until the shareholders face a subsequent liquidity need that could again be addressed with a recap. ■

Situations where recaps can help private business owners:

- Funding lifestyle requirements
- Wealth / asset diversification
- Disparate shareholder goals
  - Dividends vs. reinvestment
  - Expansion vs. status-quo
- Succession planning
- Estate planning
- Generational transitions
- Shareholder disputes
- Sharing risk with new partner
- Divorce

For more information on recaps and how they may benefit your or your clients, please contact Dan Pansing at Merit Capital Partners at (312) 592-6160 or dpansing@meritcapital.com.

Lincoln International announces the opening of its Beijing office

Joe Chang, Managing Director and CEO, Lincoln China

In January Lincoln International announced the opening of its Beijing office. As part of this expansion, Joe Chang has joined the bank as Managing Director and CEO of Lincoln International in China. Joe joins Lincoln from Morgan Stanley, where he was a Managing Director and Head of Investment Banking at Morgan Stanley Huaxin Securities.

Lincoln International now has 14 offices worldwide, including 11 in the top nine global economies ranked by GDP. With the opening of its Beijing office, Lincoln International now has offices in all of the "BRIC" countries.

Lincoln International has been active with Chinese companies since 2003 and has had personnel located in either Hong Kong or Shanghai since 2006. Historically, the focus of Lincoln International in China has been finding buyers on sell-side mandates for non-Chinese companies.

Lincoln International in China will offer highly effective M&A advisory and capital raising services to its Chinese clients by leveraging its active mid-market M&A and capital raising practices in Europe, North America, Japan, India, Russia and South America. While providing a full range of M&A services, the Beijing office will provide a best-in-class platform for introducing Chinese buyers to sell-side opportunities located outside of China.

On Lincoln's expanding presence in China, Joe Chang commented, "Chinese corporates are looking at cross-border M&A as a way to buy technology, brands and increase competitiveness both at home and abroad. There are more than 2,400 Chinese corporations listed on the Shanghai and Shenzhen stock exchanges and many of them have the financial flexibility to compete successfully in cross-border, mid-market deals. Lincoln International completes over 100 deals each year, a majority of which are sell-side M&A assignments. The firm's mid-market opportunities in the U.S., Europe, Japan and other parts of the world are just what Chinese corporations want to access. I am excited to join Lincoln International and introduce these sell-side mid-market opportunities to Chinese corporates."

The Lincoln 300 Database — Lincoln's Perspectives on the Middle Market

About The Lincoln 300 Database: *Lincoln maintains an extensive proprietary database in connection with its quarterly portfolio valuation activities containing valuation and financial data for a diverse group of companies across ten primary industry segments. The database offers a glimpse into the middle-market where reliable data is otherwise limited. Valuation metrics reflect observed transaction multiples. Financial results reflect information available at the end of each calendar quarter (typically, financial statements for one or two months preceding the end of each calendar quarter). The database contains over 350 companies.*

By far, the most remarkable characteristic of the current M&A market is its similarity to 2007 with respect to deal financing. The current lending climate sets a spirited tone against what appears to be modest firm-level performance.

Since Q1 2012, financial performance has trended downward as evidenced by the percentage of companies reporting revenue and EBITDA growth (quarterly Y-O-Y). The proportion of companies with EBITDA gains increased modestly (51% in Q4 2012 vs. 47% in Q3 2012). This means that only slightly more companies reported EBITDA increases than decreases, reversing last quarter's alarming dip below the 50% mark.

Of the sectors we monitor, only technology exhibited meaningful improvements in revenue growth. Industrials demonstrated a considerable improvement in EBITDA growth while healthcare and technology also exhibited increases over prior quarter.

While M&A valuation multiples in LBO transactions remained steady through the end of the year, rising leverage multiples underscore fierce competition among lenders. Alternative lenders, such as Business Development Companies ("BDCs"), credit funds and hedge funds, continue to compete, resulting in tightening in loan pricing. However, their investor return requirements have mitigated some compression in yields, contributing instead to fiercer competitions on terms.

Presented below are selected data from our Q4 2012 valuation activities as captured by our proprietary database. As usual, the number of companies in our database continues to grow.

M&A Transactions

	Q1 '11	Q2 '11	Q3 '11	Q4 '11	Q1 '12	Q2 '12	Q3 '12	Q4 '12
TEV / EBITDA	6.8x	6.6x	6.0x	7.1x	7.2x	6.6x	7.8x	7.4x
Total Debt / EBITDA	3.5x	3.9x	3.4x	3.7x	3.7x	3.9x	4.4x	3.9x
Senior Debt / EBITDA	2.6x	3.2x	2.7x	3.0x	2.7x	3.2x	3.2x	3.1x
Equity % of Total Cap	47%	39%	41%	45%	44%	39%	44%	48%
LTM EBITDA (Average)	$12	$33	$21	$19	$32	$32	$36	$33

Commentary:

- Average total enterprise value (TEV) to LTM EBITDA multiple implied by closed M&A transactions decreased in Q4 2012 to 7.4x, down from 7.8x in Q3 2012.
- Similarly, average total leverage decreased to 3.8x from 4.4x in the prior quarter.
- Average equity contribution increased to 48% from 44% in the prior quarter

% Financial Growth Rates (Mean)

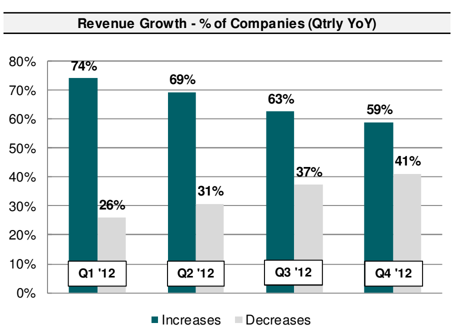
By Size:

	Q4 '12 LTM	Q3 '12 vs. Q3 '11		Q4 '12 vs. Q4 '11	
EBITDA	**EBITDA Margin**	**Revenue**	**EBITDA**	**Revenue**	**EBITDA**
$0 - $10	18.6%	2.9%	0.0%	-1.5%	-7.4%
$10 - $50	18.8%	10.5%	0.1%	4.6%	4.4%
> $50	25.2%	1.6%	-3.7%	8.0%	-2.6%
Total	**20.3%**	**5.2%**	**-1.2%**	**3.3%**	**-1.0%**

By Industry:

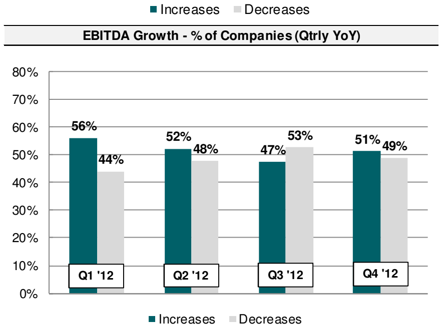
	Q4 '12 LTM	Q3 '12 vs. Q3 '11		Q4 '12 vs. Q4 '11	
Industry Sector	**EBITDA Margin**	**Revenue**	**EBITDA**	**Revenue**	**EBITDA**
Business Services	19.4%	3.8%	-2.5%	-2.7%	-4.8%
Consumer	17.2%	2.2%	-1.7%	1.2%	-3.2%
Healthcare	20.5%	8.5%	0.8%	8.7%	1.7%
Industrials	16.8%	7.2%	-5.8%	-2.9%	4.6%
Technology	25.0%	-3.8%	-0.6%	4.2%	2.8%
Total	**20.3%**	**4.4%**	**-1.2%**	**3.0%**	**-1.0%**

Revenue & EBITDA Trends



Commentary:

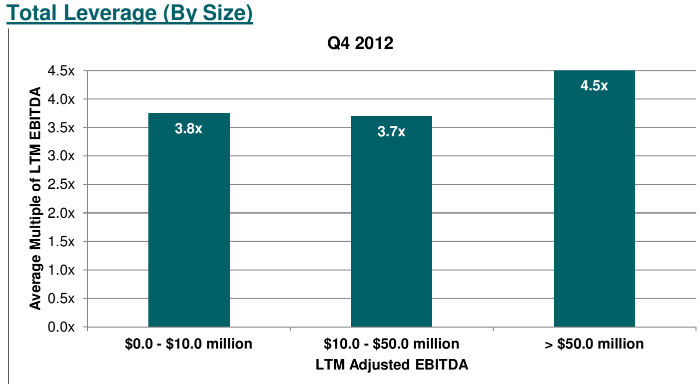
- Approximately 59% of the companies observed reported revenue growth in Q4 2012 vs. Q4 2011. This percentage was a decrease from 63% in the prior quarter.

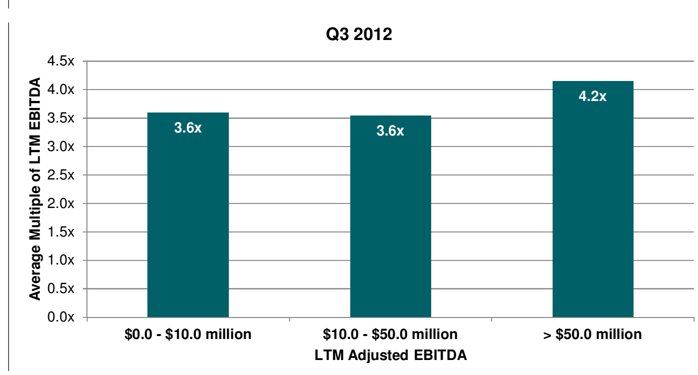


- On the positive side, more companies reported EBITDA gains (51% in Q4 2012 vs. 47% in Q3 2012) despite overall economic uncertainty and weak consumer confidence

Note: Aerospace & Defense, Automotive & Truck, Chemicals, Energy, and Financial Services excluded due to limited historical data

Total Leverage (By Size)

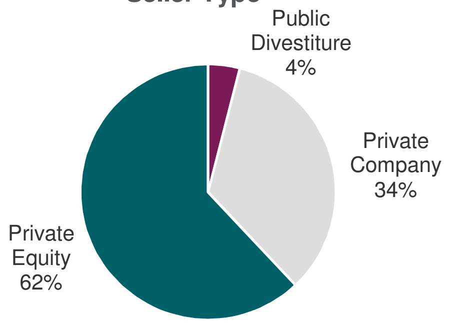




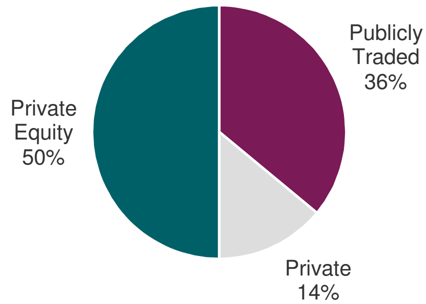
The Market Pulse: DATA THAT AFFECTS THE MID-MARKET M&A LANDSCAPE

Lincoln Completed Transaction Data (N. America) — Last 12 Months Ended December 31, 2012

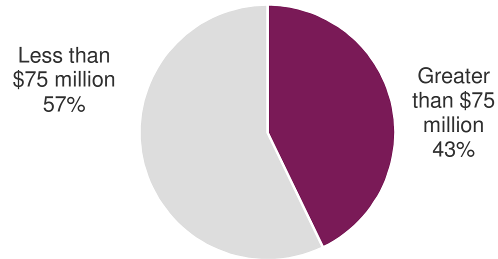
Seller Type



Buyer Profile



Enterprise Value



Valuation Statistics: Average Enterprise Value Multiples
Compared to last 12 months ended December 31, 2012

	EV / LTM EBITDA				EV / LTM Revenue			
	Adj. Mean		Median		Adj. Mean		Median	
Less than $75 million	6.68x	▲	6.58x	▲	0.94x	▼	0.71x	▼
Greater than $75 million	7.01x	▼	6.97x	►	1.28x	▲	1.28x	▲

Note: Arrows denote comparison with M&A transactions completed during the 12 months ended September 30, 2012; adjusted mean excludes high and low values prior to mean average calculation

Observations

- Valuation multiples have remained stable
- Larger companies' premiums over smaller businesses, as measured by EBITDA and Revenue multiples, have remained relatively stable or declined slightly

Key Purchase Agreement Terms — Lincoln's North American transactions

Last 12 months ended December 31, 2012 compared to last 12 months ended September 30, 2012

Escrow as a Percentage of Purchase Price

	EV < $75 mm				EV > $75 mm			
	Mean		Median		Mean		Median	
All Sellers	**8.95%**	▲	**10.00%**	▲	**7.33%**	▲	**6.50%**	►
Public Buyers	9.13%	▲	10.00%	▲	9.13%	▲	9.00%	▲
Private Equity Buyers	8.00%	▼	8.00%	▼	5.00%	▲	5.00%	►
Private Buyers	13.00%	►	13.00%	►	9.50%	▲	9.50%	▲
Private Sellers	**11.25%**	▼	**10.00%**	►	**7.83%**	▼	**7.50%**	▼
Public Buyers	11.00%	▼	10.00%	▼	8.00%	▼	8.00%	▼
Private Equity Buyers	10.33%	►	10.00%	►	6.00%	►	6.00%	►
Private Buyers	13.00%	►	13.00%	►	9.50%	▲	9.50%	▲

Indemnity Cap as a Percentage of Purchase Price

	EV < $75 mm				EV > $75 mm			
	Mean		Median		Mean		Median	
All Sellers	**14.84%**	▼	**10.00%**	►	**9.94%**	▲	**10.00%**	►
Public Buyers	16.00%	▼	10.50%	▼	10.67%	▲	11.00%	▼
Private Equity Buyers	10.67%	▼	10.00%	►	8.83%	▲	10.00%	▲
Private Buyers	15.00%	►	15.00%	►	12.00%	►	12.00%	▼
Private Sellers	**12.20%**	▼	**10.00%**	▼	**11.50%**	▼	**11.50%**	▼
Public Buyers	11.00%	▼	11.00%	▼	11.00%	►	11.00%	▼
Private Equity Buyers	10.00%	►	10.00%	►	9.00%	►	9.00%	►
Private Buyers	10.00%	►	10.00%	►	12.00%	▼	12.00%	▼

Basket as a Percentage of Purchase Price

	EV < $75 mm				EV > $75 mm			
	Mean		Median		Mean		Median	
All Sellers	**0.82%**	▼	**0.75%**	▼	**1.16%**	▲	**1.00%**	►
Public Buyers	0.86%	▼	0.83%	▼	0.82%	▼	1.00%	▲
Private Equity Buyers	0.78%	▼	0.67%	▼	1.00%	►	1.00%	►
Private Buyers	0.84%	►	0.84%	►	3.08%	▲	3.08%	▲
Private Sellers	**0.87%**	▲	**1.00%**	►	**1.73%**	▲	**1.00%**	▲
Public Buyers	0.88%	▲	0.91%	►	0.75%	▲	0.75%	▲
Private Equity Buyers	0.82%	►	1.00%	►	1.00%	►	1.00%	►
Private Buyers	1.00%	►	1.00%	►	3.08%	▲	3.08%	▲

General Indemnity Term (in months)

	EV < $75 mm				EV > $75 mm			
	Mean		Median		Mean		Median	
All Sellers	**17.19**	▼	**18.00**	►	**19.17**	▲	**18.00**	►
Public Buyers	18.63	▲	18.00	►	21.38	▲	18.00	►
Private Equity Buyers	14.60	▼	14.00	▼	17.63	▼	18.00	▲
Private Buyers	22.00	►	18.00	►	16.50	▲	16.50	▲
Private Sellers	**19.25**	▲	**18.00**	►	**16.50**	▼	**18.00**	▲
Public Buyers	19.00	▲	18.00	►	15.00	▼	15.00	▼
Private Equity Buyers	14.33	►	15.00	►	18.00	►	18.00	►
Private Buyers	27.00	►	27.00	►	16.50	▲	16.50	▲

Observations

- In general, terms have remained relatively stable, as uncertainty in the marketplace discourages deviation from the status quo
- Public strategic acquirers remain active
- Lenders are more active, driving private equity groups to be more flexible on terms

Legend	
▲	Increase vs. prior period
▼	Decrease vs. prior period
►	No change

Note: Arrows denote comparison with transactions completed during the 12 months ended September 30, 2012
Source: Lincoln International

Selected Recent Lincoln International Transactions

MCM has sold Dexmet Corporation to SVERICA International

- Sell-side transaction (March 2013)
- Dexmet Corporation is the technical leader in the development and production of highly engineered, expanded thin ductile foils and polymeric materials serving a variety of mission critical applications in aerospace and other high growth end markets. The company is headquartered in Wallingford, CT.
- Acquired by Sverica International, a leading private equity firm that has raised over $425 million of investment capital. The company is headquartered in Boston, Massachusetts.

an operating subsidiary of Handy&Harman Ltd. has been sold to HUBBELL

- Sell-side transaction (January 2013)
- Continental Industries, Inc. is a leading provider of exothermic welding products and connectors, serving the gas, water utility, infrastructure, construction, electric utility and mobile telecommunication markets. The company is headquartered in Tulsa, Oklahoma.
- Acquired by Hubbell Incorporated, an international manufacturer of quality electrical and electronic products for a broad range of non-residential and residential construction, industrial and utility applications. The company is headquartered in Sheldon, Connecticut.

HuntsmanGay Global Capital has sold Power Holdings and its subsidiaries T&D Solutions Diversified Services to Kelso & Company

- Sell-side transaction (December 2012)
- Power Holdings is a leading provider of outsourced maintenance and construction services to electric utility industry, including transmission, substation, overhead and underground distribution, and storm recovery. The company is headquartered in Alexandria, Louisiana and Hartselle, Alabama.
- Acquired by Kelso & Company, one of the oldest and most established firms specializing in private equity for $380 million. Since 1980, Kelso has invested in over 115 companies in a broad range of industry sectors with aggregate initial capitalization at closing of over $40 billion.

Wells Manufacturing Company including Dura-Bar and Dura-Bar Metal Services has been sold to Charter Manufacturing

- Sell-side transaction (December 2012)
- Dura-Bar is a world leader in the production, technology and application of continuous cast iron bar stock, and Dura-Bar Metal Services is a distributor of Dura-Bar products and bronze alloys. The company is headquartered in Woodstock, Illinois.
- Acquired by Charter Manufacturing, a privately-held holding company for a group of leading manufacturers of steel and steel components. The company is headquartered in Mequon, Wisconsin.

Saturn Electronics & Engineering, Inc. has been sold to FLEXTRONICS

- Sell-side transaction (November 2012)
- Saturn Electronics & Engineering, Inc. is a leading manufacturer of electronics, solenoids, and wiring harness products for original equipment manufacturers and their suppliers in the United States and internationally. The company is headquartered in Rochester Hills, Michigan.
- Acquired by Flextronics International Ltd. (NasdaqGS:FLEX), a provider of design and manufacturing services to original equipment manufacturers worldwide. The company is based in Singapore.

defibtech has been sold to NIHON KOHDEN

- Sell-side transaction (November 2012)
- Defibtech is a leading manufacturer of resuscitation equipment in the U.S., with more than 160,000 AED devices delivered throughout the world. The company is based in Guilford, Connecticut.
- Acquired by Nihon Kohden Corporation (TSE:6849), a developer, producer, and seller of medical electronic equipment worldwide. The company is based in Tokyo, Japan.

Lincoln International's Global Footprint

100+ professionals throughout the United States

100+ professionals plus a 24-person advisory board in Europe

Offices throughout the "BRIC" economies of Brazil, Russia India and China

Indicates Lincoln International office

About Lincoln International

Lincoln International specializes in merger and acquisition advisory services, private capital raising, and restructuring advice on mid-market transactions. Lincoln International also provides fairness opinions, valuations and pension advisory services on a wide range of transaction sizes. With fourteen offices in Asia, Europe and the Americas, Lincoln International has strong local knowledge and contacts in the key global economies. The organization provides clients with senior-level attention, in-depth industry expertise and integrated resources. By being focused and independent, Lincoln International serves its clients without conflicts of interest. More information about Lincoln International can be obtained at **www.lincolninternational.com.**

Industry Groups

Lincoln International's dedicated industry verticals are organized on a global basis and led by senior professionals with significant advisory and sector expertise:

- Aerospace and Defense
- Automotive and Truck
- Building and Infrastructure
- Business Services
- Chemicals
- Consumer
- Electronics
- Healthcare
- Industrials
- Packaging
- Renewable Energy
- Technology
- Transportation and Logistics

Lincoln International Contacts

Patrick Goy
Managing Director
pgoy@lincolninternational.com
+1-312-580-8320

Scott Hebbeler
Director
shebbeler@lincolninternational.com
+1-312-580-8336

M. Todd Reid
Associate
treid@lincolninternational.com
+1-312-506-2733

Colin Keeler
Analyst
ckeeler@lincolninternational.com
+1-312-506-2774

Lincoln INTERNATIONAL

Results you can rely on

AMSTERDAM | BEIJING | CHICAGO | FRANKFURT | LONDON
LOS ANGELES | MADRID | MOSCOW | MUMBAI
NEW YORK | PARIS | SÃO PAULO | TOKYO | VIENNA