DEALREADER | Private Company Group

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

February 2013

Inside this Issue

Welcome to the February 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 Mary Josephs of Chicago-based investment bank and ESOP advisory firm Verit Advisors, LLC. Ms. Josephs discusses how an ESOP transaction can help prospective sellers address unique shareholder dynamics in a challenging economic environment. Her interview provides an overview of ESOPs and explains how such a transaction can offer owners with liquidity while simultaneously providing a tax-efficient solution to many other stakeholders.

Other topics covered in this issue include:

- An introduction to 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 Power Holdings to Kelso & Company, one of the oldest and most established firms specializing in private equity

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

Lincoln International

Five Questions For: Mary Josephs, Verit Advisors, LLC - ESOP Advisory

Mary Josephs, Founder & CEO of Verit Advisors, a leading ESOP advisory firm

Verit Advisors unites sophisticated middle market investment banking capabilities with a client centric boutique, fluent in Employee Stock Ownership Plans (ESOPs), debt and equity capital markets, and mergers and acquisitions.

Ms. Josephs founded Verit Advisors in 2009 and has nearly three decades of experience in the world of corporate finance. Josephs and her team are considered to be the foremost experts in ESOP transactions and middle market strategic alternatives.

Also featured is Peter Abrahamson, who has more than 15 years of experience in the valuation of business enterprises and individual securities, structuring ESOP transactions, and executing public and private market capital raises.

We asked Ms. Josephs and Mr. Abrahamson five questions about ESOP transactions, and why, given current market conditions, ESOPs have become a popular and often compelling middle market transaction consideration.

Q: Who is Verit Advisors, LLC?

A: Verit Advisors is a middle market investment banking advisory firm and national leader in ESOP advisory and finance, having represented over 300 companies in the past 25 years. Through diverse leadership backgrounds, our team has the foremost experience in unbiased ESOP transaction structuring, debt and equity capital markets placements, mergers and acquisitions, recapitalizations and valuation services.

Q: What is an ESOP?

A: ESOPs are a corporate finance alternative, most common with middle market privately held businesses. Since 1975, employee ownership growth has been supported by unique tax advantages, increased company performance, and market dynamics that make ESOPs a very competitive middle market exit alternative. With over 11,000 ESOP companies in the U.S., ESOPs contribute to 10% of the private sector workforce, or 10.3 million employees. Many of these employees work for 100% ESOP-owned S-Corporations (S-Corps), where the company and the ESOP pay no federal income taxes; ESOP participants pay income tax when they receive distributions from their accounts, typically at retirement. In a 2012 study, completed by Alex Brill, a former policy director and chief economist of the House Ways and Means Committee, concluded that S-Corp ESOP companies grew employment by 60% over the past decade, whereas jobs in the private economy, as a whole, remained relatively flat.

Little known fact: The number of ESOP companies exceeds the number of publicly held companies and the number of private equity-owned companies

C-Corporation companies have their own unique tax advantages in a leveraged ESOP, or stock sale to the ESOP, transaction. Most notably, the selling shareholder, subject to certain limitations, is able to defer capital gains tax if proceeds are reinvested in qualified securities. With such transactional diversity available through employee ownership, ESOPs provide attractive transaction alternatives.

While ESOPs are appealing from an ownership transition and corporate finance lens, ESOPs are also good for the economy. Employee owned companies continue to outperform comparable public and private corporations, providing a greater retirement benefit to employees. According to the University of Pennsylvania, S-Corp ESOP companies generate

(Continued on page 2)

(Verit Advisors, continued from page 1)

approximately $14 billion in retirement savings that would not have existed in the absence of the S-Corp structure.

Q: Given the state of existing M&A market, and with both strategic and private equity alternatives well prepared to execute acquisitions, why an ESOP?

A: Surely we've seen great success stories in the capital markets with high profile and high growth investment opportunities experiencing investor demand across the debt and equity markets. That said, companies with flat to modest growth have more difficulty finding investor demand. Because of industry taint, lack of robust growth plan, unusual history, niche industry, or other unique story, demand may be muted. These conditions have private equity firms and closely held business owners turning to ESOPs as a viable alternative for many reasons:

Valuation: ESOPs enable business owners to sell at fair market value, as negotiated with an independent trustee and advisor. This is supported by standards that IRS and Department of Labor (DOL) guidelines provide in valuing securities not traded on a public market. With fair market value being standard in ESOP transactions, PE firms can bypass the auction process common to the M&A process.

Certainty of close: In addition to a competitive price, ESOPs can also provide a higher certainty of close relative to non-ESOP alternatives. For example, 98% of Verit's over 250 ESOP transactions have closed, a metric unheard of in traditional M&A. As a result, ESOPs prove to work well in a dual-track process, where the selling shareholder can simultaneously engage in an M&A and ESOP process.

Minority liquidity or partial sale: Not all owners think alike. Family members are challenged when some want out and others want in. The use of an ESOP as a friendly marketplace for minority shareholder liquidity provides fair ownership transfers, enabling those who want to continue with the business to retain equity. This also works for private equity exits where management or founders desire to remain with the company.

Q: How do seller's achieve liquidity with sale to an ESOP?

A: ESOP financing should essentially look like leveraged finance or a dividend recap, only better. There are robust capital alternatives for financing ESOP transactions including: traditional senior debt capital, mezzanine capital, seller financing and employee equity. Verit has extensive relationships with senior lenders and mezzanine lenders who are actively seeking to lend to ESOP owned companies. These lenders understand the structural and business nuances that exist within an ESOP company and are able to provide financing packages in a timely manner. It is our experience that certain ESOP structures increase the amount of available commercial debt financing vis-à-vis other alternatives.

ESOPs can attract unique sources of funds including employee equity from qualified retirement plans such as 401k plans, management equity investment from personal after-tax sources, equity from compensation concessions, special economic development support, or equity from redirecting previous payments for other benefit plan(s) to the ESOP.

Tax savings improve ESOP companies' debt capacity. Hence, ESOP transactions can have increased cash flow available for debt service as compared to alternatives. Contributions to the ESOP, which are often non-cash in nature, are tax deductible in both a C-Corp and an S-Corp structure. Additionally, an ESOP is a permitted S-Corp shareholder and is not subject to Unrelated Business Income Tax, therefore the earnings of an S-Corp attributable to the ESOP are not taxed. These increased cash flows from the ESOP structure can be utilized to service debt and deleverage the balance sheet and generally enhance cash flow and fixed charge coverage for lenders all while increasing investment returns. This advantage also drives growth in equity value for the ESOP.

"ESOPs prove to work well in a dual-track process, where the selling shareholder can simultaneously engage in an M&A and ESOP process."

Q: How does Verit traditionally structure ESOP engagements?

A: Verit's approach is to work with its clients in a two-phase structure; a design and structure phase and then a separate implementation phase. The design and structure phase typically provides a business owner with an ESOP transaction blueprint which includes valuation analysis, recommended structure, capital sources and uses, returns analysis, employee benefit analysis and other terms and conditions pertinent to the proposed ESOP transaction. The design phase provides a business owner with the comprehensive information needed to evaluate the economics of an ESOP transaction and make a decision whether to move forward with the transaction. Our clients are typically under no obligation to proceed with an ESOP transaction at the end of the design phase.

The design phase work can be done in conjunction with a traditional sell-side M&A process, a dual-track process. Or the work can be done in advance of a sell-side M&A process to establish a "bid" against which to establish minimums that other interested parties in the M&A process must commit to. We see many situations where there has been a "failed auction" and the ESOP process is explored at the end of the process which can compromise and limit valuation results.

The implementation phase takes place when the business owner decides to move forward with an ESOP transaction. Verit then serves as both company side advisor (including negotiations and, if desired, capital raise) and transaction "quarterback", leading the company through implementation alongside company's legal, tax, wealth, and accounting advisors.

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To find out if an ESOP is the right option for your company, contact:

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About Verit Advisors

- **Founded in 2009, Verit Advisors is a nationally-recognized market leader in a variety of complex ESOP structures and transactions**
- **It has rich experience with the entire gamut of ESOP and ESOP-related scenarios, including:**
  - **Structuring sales to newly created ESOPs**
  - **Partial S-Corporation and C-Corporation ESOP transformations**
  - **ESOP restructurings**
  - **Sales of ESOP-owned companies**
  - **ESOP terminations and buyouts**
- **More information is available at *www.verit.com***

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 approximately 300 companies.*

What many of us had expected to be a mad rush to get a wave of M&A deals closed by year end, in anticipation of higher capital gains taxes, did not materialize, leaving us to wonder, "what happened?" Uncertainty around federal tax policy and the "fiscal cliff" are, of course, top of mind, but we suspect more fundamental considerations are at play. Our private equity friends are reporting up to a 20% to 30% drop in deal flow over the past three months which they attribute to softening earnings, a trend we have observed among the many private companies we value on a quarterly basis, as well as our own active M&A transactions.

Quarterly year-over-year (YoY) financial performance deteriorated in Q3 2012 with the lowest percentage of companies reporting revenue and EBITDA growth in at least four quarters. Perhaps most alarmingly, for the first time since we began tracking this data, more companies reported EBITDA declines than increases. Of the sectors we monitor, healthcare seemed to fare the best, though average EBITDA growth was unimpressive. Despite these factors, average M&A valuation multiples in LBO transactions held steady throughout the year as leverage continues to tick up amidst high competition among lenders for new financings resulting in some tightening in loan pricing. Alternative lenders, such as Business Development Companies ("BDCs"), credit funds and hedge funds, however, can only compete so much on price given their investor return requirements, which has mitigated the compression in yields, but contributed to more competition on terms.

Presented below are selected data from our Q3 2012 valuation activities as captured by our proprietary database.

M&A Transactions

	Q1 '11	Q2 '11	Q3 '11	Q4 '11	Q1 '12	Q2 '12	Q3 '12
TEV / EBITDA	6.8x	6.6x	6.0x	7.1x	7.2x	7.4x	7.4x
Total Debt / EBITDA	3.5x	3.9x	3.4x	3.7x	3.7x	4.1x	4.4x
Senior Debt / EBITDA	2.6x	3.2x	2.7x	3.0x	2.9x	3.5x	3.2x
Equity % of Total Cap	47%	39%	41%	45%	45%	44%	41%
LTM EBITDA (Average)	$12	$33	$21	$19	$40	$35	$35

Commentary:

- Average total enterprise value (TEV) to LTM EBITDA multiple implied by closed M&A transactions in Q3 2012 was 7.4x, which is in line with the figure from Q2.
- Although TEV / EBITDA multiples remained unchanged, average total leverage increased from 4.1x to 4.4x. The increase in leverage was driven by larger availability of

% Financial Growth Rates (Mean)

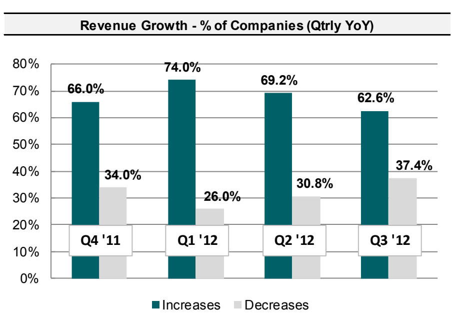
By Size:

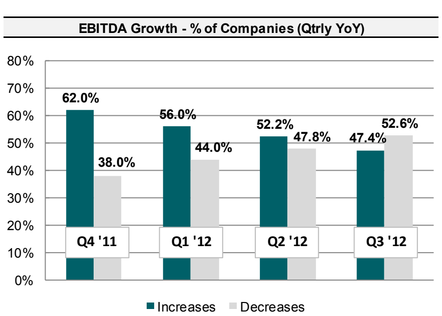
	Q3 '12 LTM	Q3 '12 vs. Q3 '11		Q2 '12 vs. Q2 '11	
EBITDA	EBITDA Margin	Revenue	EBITDA	Revenue	EBITDA
$0 - $10	19.0%	2.9%	0.0%	6.5%	-7.8%
$10 - $50	19.9%	10.5%	0.1%	7.9%	5.6%
> $50	25.8%	1.6%	-3.7%	4.6%	0.2%
Total	**21.1%**	**5.2%**	**-1.2%**	**6.4%**	**0.3%**

By Industry:

	Q3 '12 LTM	Q3 '12 vs. Q3 '11		Q2 '12 vs. Q2 '11	
Industry Sector	EBITDA Margin	Revenue	EBITDA	Revenue	EBITDA
Business Services	20.6%	3.8%	-2.5%	1.4%	-1.9%
Consumer	18.9%	2.2%	-1.7%	5.6%	-2.2%
Healthcare	26.0%	8.5%	0.8%	6.0%	-1.9%
Industrials	17.8%	7.2%	-5.8%	10.8%	11.3%
Technology	22.3%	-3.8%	-0.6%	0.5%	2.0%
Total	**21.1%**	**4.4%**	**-1.2%**	**5.6%**	**0.3%**

Revenue & EBITDA Trends



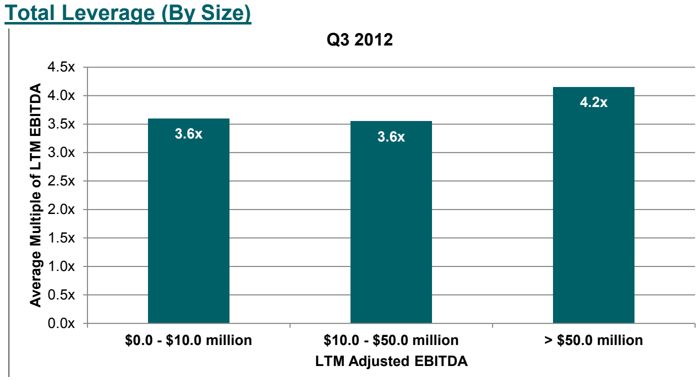


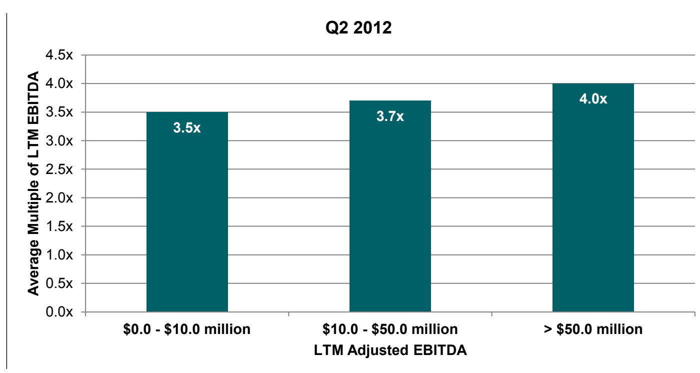
Commentary:

- Approximately 63% of the companies observed reported revenue growth in Q3 2012 vs. Q3 2011. This percentage was a decrease from 69% in the prior quarter.
- Similarly, fewer companies reported EBITDA gains (47% in Q3 2012 vs. 52% in Q2 2012). Lincoln attributes this trend to continued margin compression resulting from higher commodity prices in certain industries and a restoration of SG&A to support top-line growth, a reversal of historical cost-cutting during the recession.

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

Total Leverage (By Size)

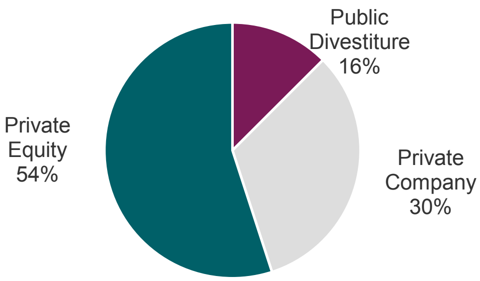




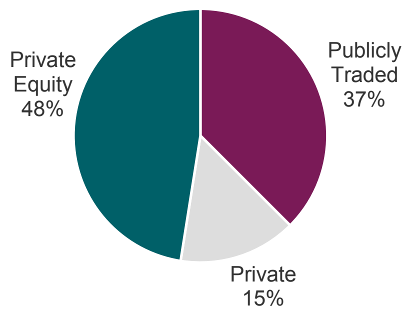
The Market Pulse: Data That Affects The Mid-Market M&A Landscape

Lincoln Completed Transaction Data (N. America) — Last 12 Months Ended September 30, 2012

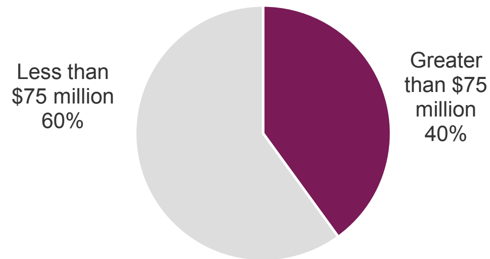
Seller Type



Buyer Profile



Enterprise Value



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

	EV / LTM EBITDA				EV / LTM Revenue			
	Adj. Mean		Median		Adj. Mean		Median	
Less than $75 million	6.46x	▼	6.49x	▼	0.97x	▲	0.80x	▼
Greater than $75 million	7.64x	▲	6.97x	▼	1.20x	▼	1.05x	▼

Note: Arrows denote comparison with transactions completed during the 12 months ended March 31, 2012; adjusted mean excludes high and low values prior to mean average calculation

Observations

- Valuation multiples have declined slightly over recent months
- Larger companies' premiums over smaller businesses, as measured by EBITDA and Revenue multiples, have remained the same or widened slightly

Key Purchase Agreement Terms — Lincoln's North American transactions

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

Escrow as a Percentage of Purchase Price

	EV < $75 mm				EV > $75 mm			
	Mean		Median		Mean		Median	
All Sellers	**8.94%**	▲	**9.00%**	▲	**6.92%**	▲	**6.50%**	▼
Public Buyers	8.67%	▲	7.00%	▲	7.75%	▼	7.00%	▼
Private Equity Buyers	8.22%	▲	9.00%	▲	4.33%	▼	5.00%	►
Private Buyers	13.00%	▲	13.00%	►	8.00%	►	8.00%	►
Private Sellers	**12.14%**	▲	**10.00%**	►	**10.00%**	►	**11.00%**	►
Public Buyers	14.00%	▲	14.00%	▲	11.00%	►	11.00%	►
Private Equity Buyers	10.33%	▲	10.00%	▲	n/a	►	n/a	►
Private Buyers	13.00%	▲	13.00%	▲	8.00%	►	8.00%	►

Indemnity Cap as a Percentage of Purchase Price

	EV < $75 mm				EV > $75 mm			
	Mean		Median		Mean		Median	
All Sellers	**16.18%**	▼	**10.00%**	▼	**9.64%**	▼	**10.00%**	►
Public Buyers	19.60%	▼	18.00%	▼	10.50%	▼	11.50%	►
Private Equity Buyers	10.88%	▼	10.00%	▼	7.50%	▼	7.50%	▲
Private Buyers	n/a	▲	15.00%	▲	n/a	▲	13.00%	▼
Private Sellers	**14.60%**	▼	**15.00%**	▼	**13.00%**	▼	**13.00%**	▼
Public Buyers	18.00%	▼	18.00%	▼	n/a	►	23.50%	▼
Private Equity Buyers	10.00%	▼	10.00%	▼	n/a	►	n/a	►
Private Buyers	n/a	▲	10.00%	▼	13.00%	▼	13.00%	▼

Basket as a Percentage of Purchase Price

	EV < $75 mm				EV > $75 mm			
	Mean		Median		Mean		Median	
All Sellers	**1.08%**	▲	**1.00%**	▲	**0.86%**	▲	**1.00%**	▲
Public Buyers	0.90%	▼	0.95%	▲	0.84%	▼	0.92%	▼
Private Equity Buyers	1.27%	▲	1.00%	▲	1.00%	▲	1.00%	▲
Private Buyers	0.84%	▼	0.84%	▼	0.52%	▲	0.52%	▲
Private Sellers	**0.85%**	▲	**1.00%**	▲	**0.65%**	►	**0.59%**	►
Public Buyers	0.82%	▼	0.91%	▲	0.71%	►	0.71%	►
Private Equity Buyers	0.82%	▲	1.00%	▲	n/a	►	n/a	►
Private Buyers	1.00%	▲	1.00%	►	0.52%	►	0.52%	►

General Indemnity Term (in months)

	EV < $75 mm				EV > $75 mm			
	Mean		Median		Mean		Median	
All Sellers	**17.58**	▼	**18.00**	►	**17.15**	▲	**18.00**	▲
Public Buyers	18.29	▼	18.00	►	17.00	▼	18.00	►
Private Equity Buyers	15.56	▼	16.00	▼	18.00	▲	16.50	▲
Private Buyers	22.00	▼	18.00	▼	15.00	▲	15.00	▲
Private Sellers	**18.88**	▼	**18.00**	►	**17.33**	►	**15.00**	►
Public Buyers	18.00	▼	18.00	▼	18.50	►	18.50	►
Private Equity Buyers	14.33	▼	15.00	▼	n/a	►	n/a	►
Private Buyers	27.00	▲	27.00	►	15.00	►	15.00	►

Observations

- In general, terms have become more buyer-friendly, reflecting slightly greater negotiating leverage for buyers able to work in abbreviated timeframes
- Public strategic acquirers and private equity groups remain active and acquisitive

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

Note: Arrows denote comparison with transactions completed during the 12 months ended March 31, 2012
Source: Lincoln International

Selected Recent Lincoln International Transactions

HuntsmanGay Global Capital has sold Power Holdings and its subsidiaries to Kelso & Company

- Sell-side transaction (December 2012)
- Power Holdings is a leading provider of outsourced maintenance and construction services to electric utility industry. Its services include transmission, substation, overhead and underground distribution, storm recovery, and broadband over powerline. The company is based in United States.
- 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.

BWK has sold Bornemann Pumps to ITT

- Sell-side transaction (November 2012)
- Bornemann Pumps is a global market leader with a strong international installed base of multiphase pumping systems for the oil and gas market. The company also serves the industrial, food and pharmaceutical sectors. The company is headquartered in Obernkirchen, Germany.
- Acquired by ITT Corporation (NYSE:ITT), a manufacturer of engineered critical components and customized technology solutions for energy infrastructure, electronics, aerospace, and transportation industries. The company is headquartered in White Plains, New York.

GreyMountain Partners has sold Robbins LLC to HEXPOL

- Sell-side transaction (November 2012)
- Robbins, LLC is a leading manufacturer of molded rubber products, including rubber inner tubes, curing tubes, precure envelopes, tire retreading accessories and mixed rubber compounds for the automotive, agricultural and mining end markets. The company is headquartered in Muscle Shoals, Alabama
- Acquired by HEXPOL AB (OM:HPOL B), a manufacturer of polymer compounds and engineered products in Europe, North America and Asia. The company is headquartered in Malmö, Sweden.

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

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Lincoln INTERNATIONAL

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