



MARKET ANALYSIS Q4 2011

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Insights

- The M&A markets appear to have reached a near-term inflexion point where the activity will turn positive or face a slowdown. Candlewood Partners remains positive about the middle market M&A activity headed into 2012.
- Global economic fears have had a negative impact on credit markets and investor sentiment, yet the 2012 election cycle could provide the catalyst for increased M&A activity
- The industrial sector remains one of the most prolific industry groups in the middle market
- Deal activity for transactions valued from \$50 million to \$100 million has held steady over the previous quarter
- Candlewood has a number of projects underway, ranging from sell-side M&A to debt and equity financings across a variety of industries and sizes

Q4 2011, History Lesson

"History is more or less bunk." Henry Ford

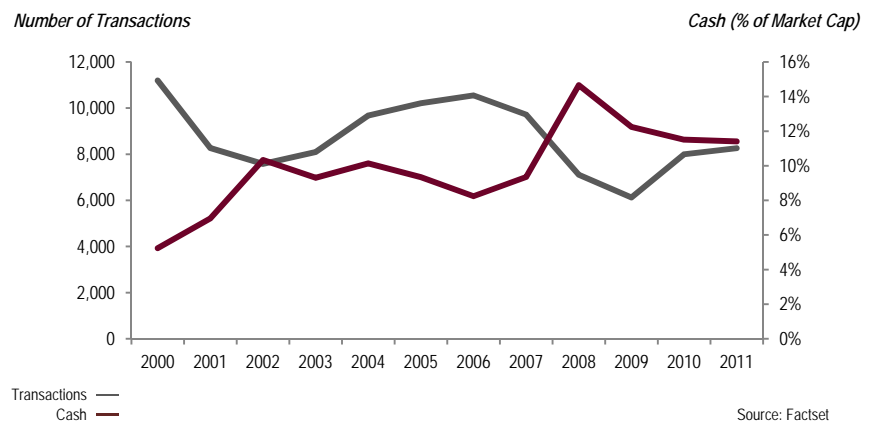
Far be it from Candlewood to disagree with the great Henry Ford, but the chart below seems to provide a fairly interesting and accurate historical portrayal of the relationship to cash positions and merger and acquisition activity.

The chart highlights cash as a percent of market cap, on aggregate, of the S&P 500, mapped against the number of transactions reported in the U.S. year over year.

Tracking the cash against transactions appears to be a predictive measure of activity, and potentially indicative of transaction values. For starters, observe the activity in the early 2000's. The economy began cooling a bit followed by an M&A slow down coming out of the tech and economic bubble of the mid-to-late 1990's. Then, 9/11 hit and the world stopped. Cash hoarding began and transactions and valuations sank.

That dry period for transactions lasted for a couple of years and then the M&A boom of 2003 to late 2008 took hold. Then 2008 happened, the world stopped again, and the transaction down cycle repeated itself. One notable difference between the first cycle and the latest is the speed with which transactions stopped and cash hoarding began. Also notable is the speed of return to more active M&A activity, spurred on by availability of capital (see charts in the following pages) and rising transaction multiples.

As you can see, it looks as if the cash v. transactions lines will either bounce or cross in the near future. If they bounce, the indication is M&A activity could drop. But over the past 10 years they have never bounced, they always crossed, even if for a brief time, creating an opposite trend for at least the following 12 months. So, the chart below suggests that we are on the verge of a new trend. We are just not sure which way the trend will go. Perhaps Henry Ford was right after all.



Mergers & Acquisitions

- Sell-side and buy-side M&A advice and execution
- Healthy and distressed situations
- Board advisory services
- Fairness opinions

Restructuring

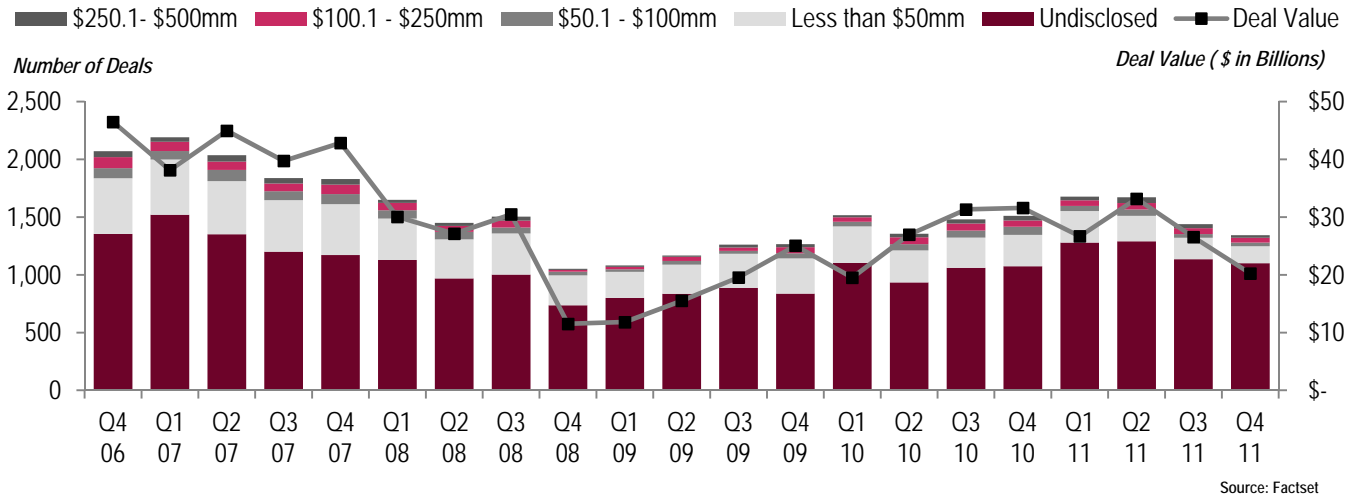
- Financial and operational restructurings
- Distressed M&A
- Infrastructure and real estate restructurings

Corporate Finance

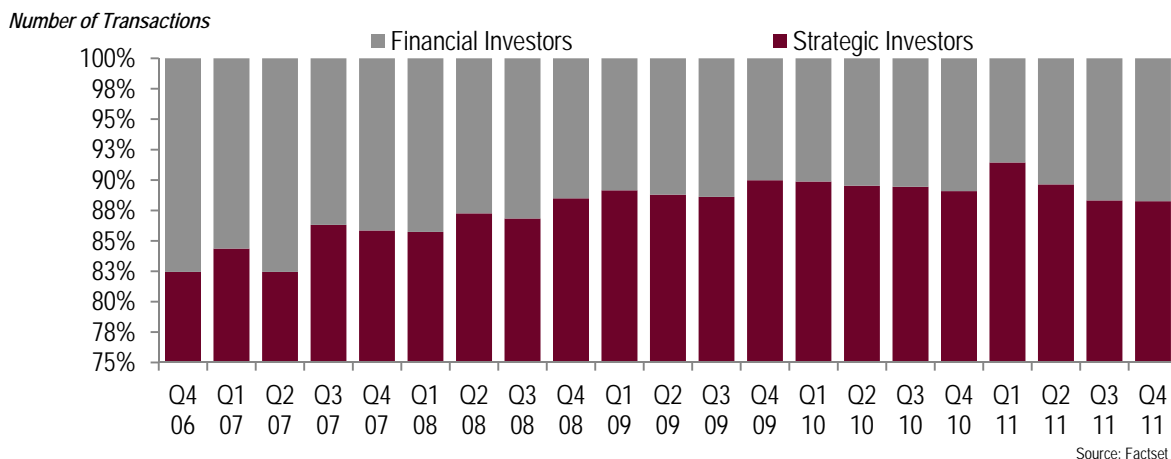
- Private placement of debt and equity, including senior and subordinated debt, and preferred and common equity
- Related board advisory services
- Valuation services

Deal Environment

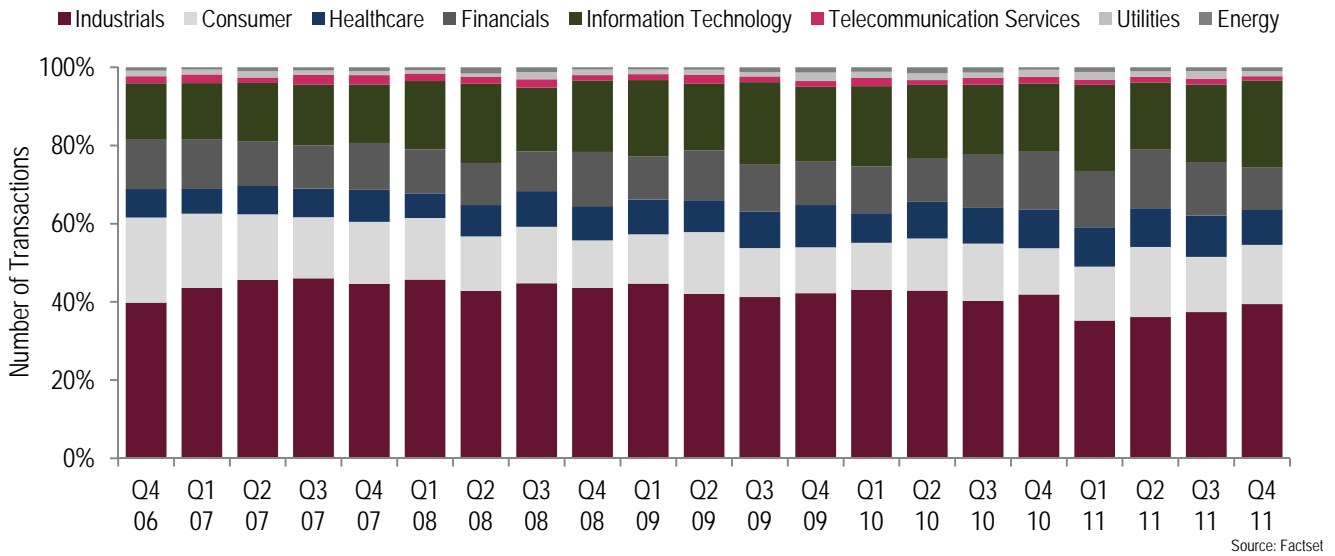
MIDDLE MARKET M&A ACTIVITY (\$500 million or less)



- Q4 2011 exhibited a significant reduction in total transaction value for both the quarter (-23.7%) and the year (-35.9%). The number of transactions also declined compared to Q3 2011, supporting the reduction in transaction values.
- In Q4 2011, deal activity for transactions less than \$50 million moved down from 186 to 146, or -21.5%. Transactions ranging from \$50 - \$100 million were unchanged at 32, while transactions of \$100 - \$250 million moved down to 42 from 51, a decrease of 17.7%. Deals of \$250 - \$500 million saw a decrease of 37.1% falling to 22 in Q4 from 35 in Q3.
- The chart above supports the graphic on the previous page, showing that the transaction count for every transaction size bracket is equal to or less than the same size bracket of Q4 2010.
- As a percentage of transactions, strategic buyer activity remains strong at over 88.0%. The financial buyer activity continues to inch toward their several year high of nearly 20%. Financial buyer activity in the middle market tends to be driven more by the availability of "good" deals, which seems to be improving.



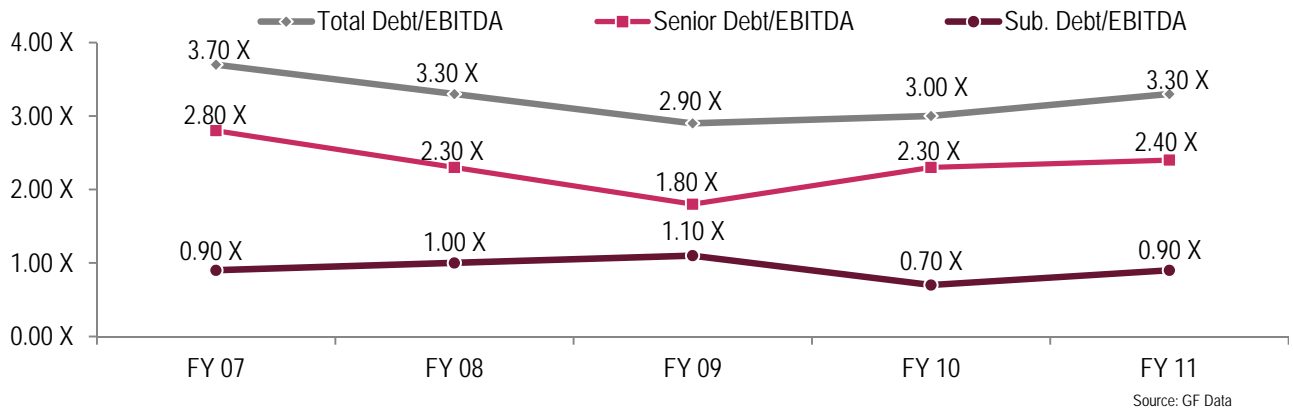
MIDDLE MARKET M&A ACTIVITY (\$500 million or less)



- The Industrials sector continues to remain one of the most prolific and growing sectors in the middle market with its fourth consecutive quarter of transaction volume growth, which is up approximately 10% from the end of Q1.
- The Industrials, Consumer, Energy and Information Technology sectors experienced quarter over quarter expansion in Q4 2011, with Information Technology seeing nearly 19.0% growth.
- The Utilities sector saw the largest sequential decline with a 29.2% decrease in deals from Q3 2011 to Q4 2011, decreasing from 24 to 17 transactions. The Healthcare sector experienced the smallest sequential decline, as deal activity fell to 118 from 132 transactions during the same time period.

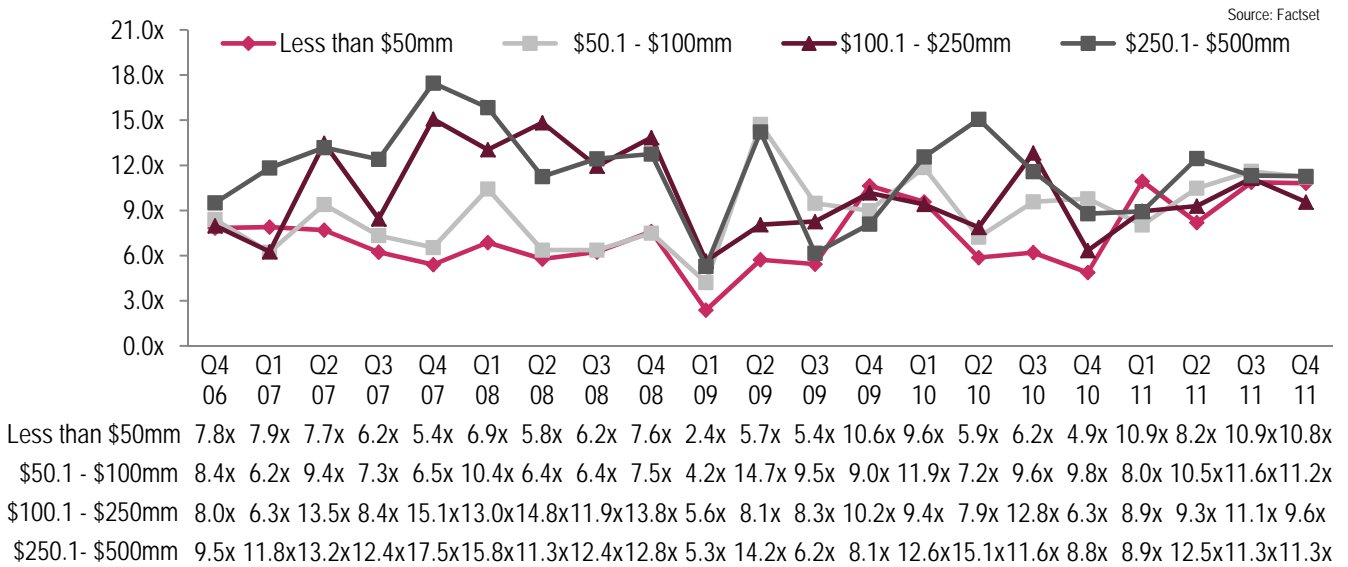
Leveraged Buyouts

DEBT MULTIPLES



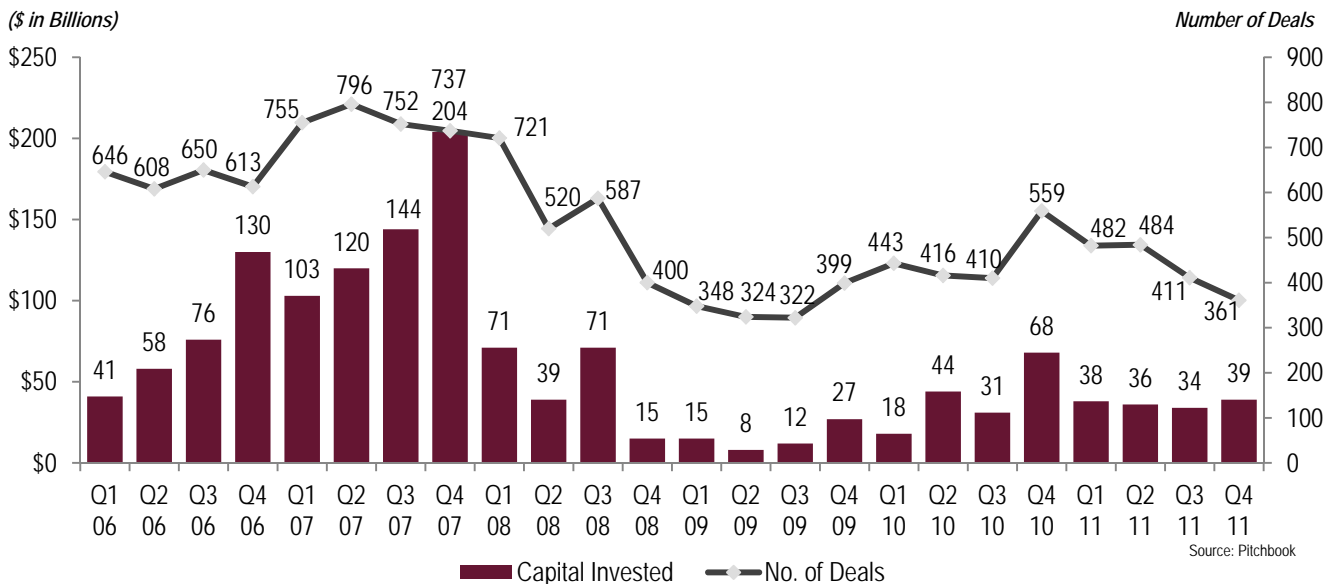
- Total debt multiples for transactions continued to rise from the 2009 lows

MIDDLE MARKET VALUATION (EV/EBITDA)



- With the decrease in both aggregate deal value and the number of transactions that occurred in Q4 2011, median enterprise value multiples for all deal values were relatively flat from the prior quarter.

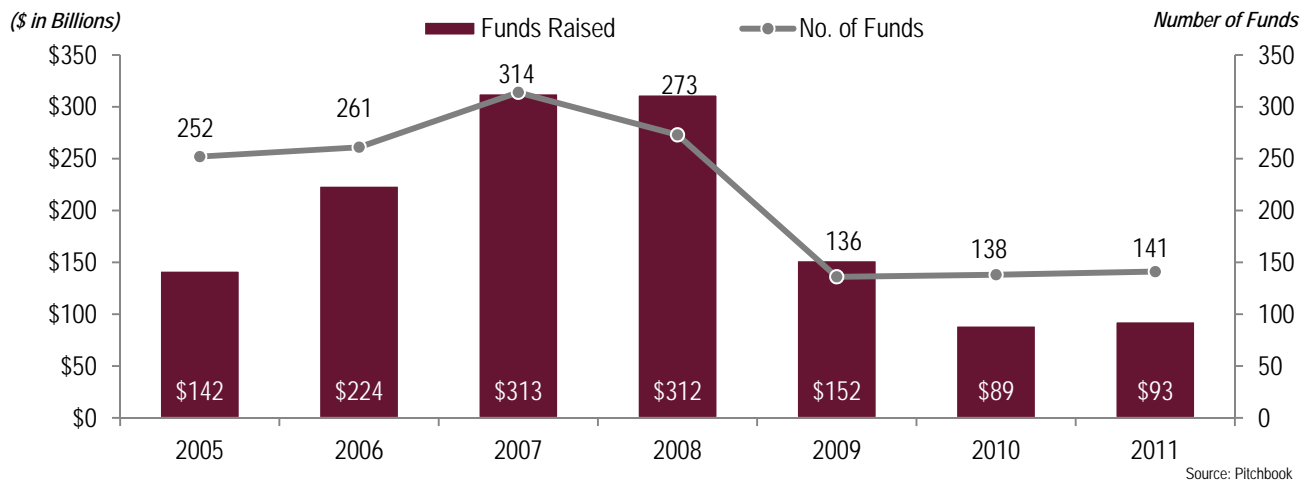
INVESTED CAPITAL



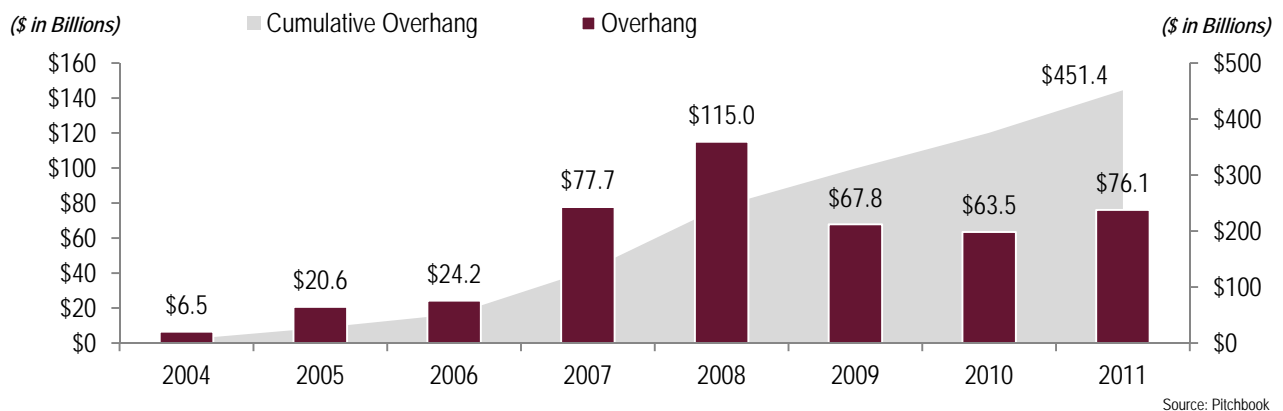
- Private equity investment per transaction in Q4 2011 was \$5 billion more than in Q3 2011, with the average financial sponsor deal size reaching \$108 million v. \$83 million in Q3.

Private Equity Funds

FUNDS RAISED

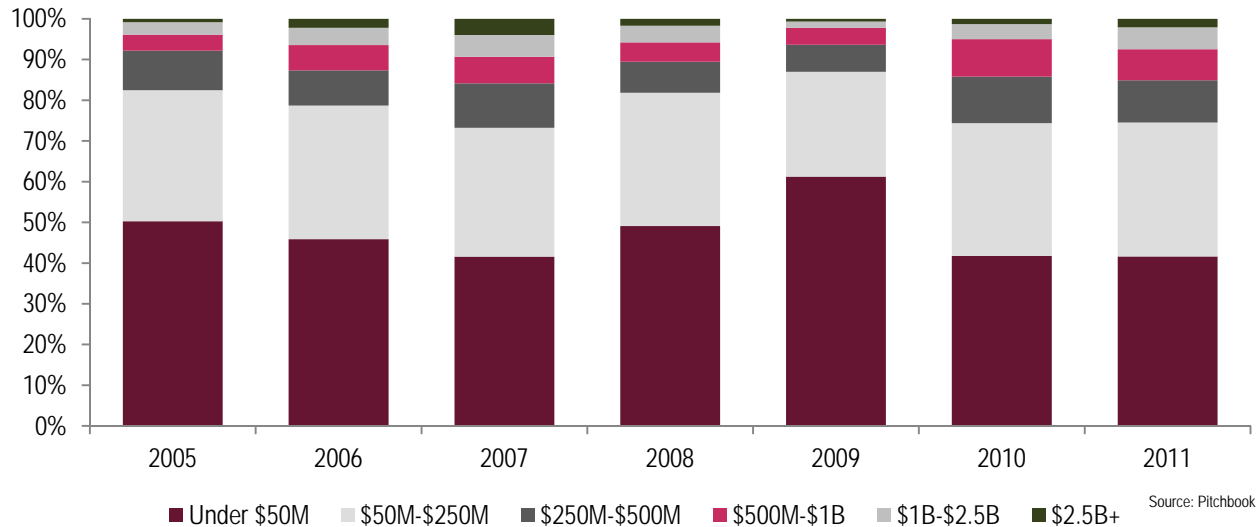


CAPITAL OVERHANG



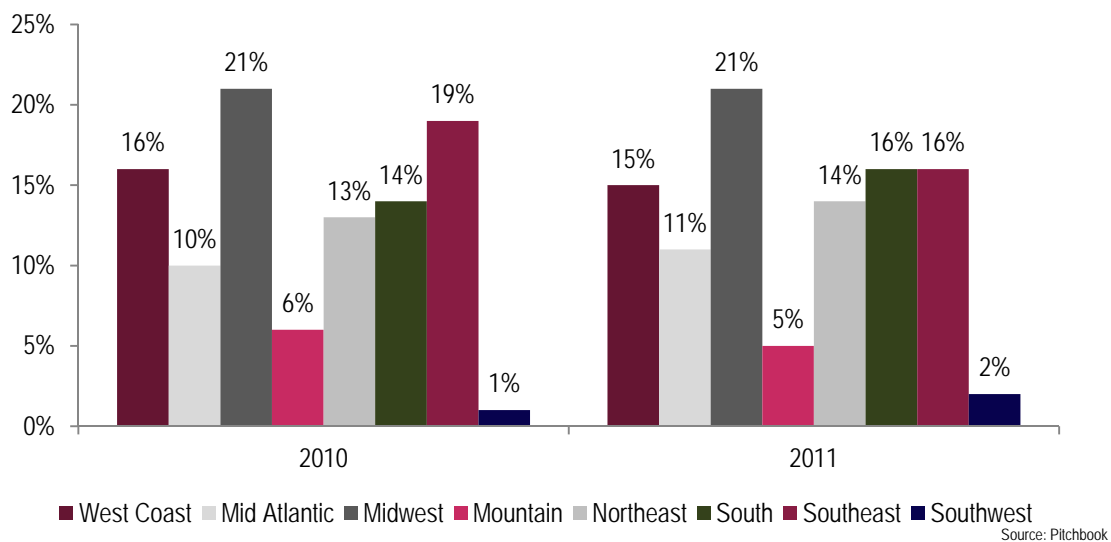
- Private equity funds raised approximately \$93 billion in 2011, as compared to \$89 billion in 2010 and \$152 billion in 2009.
- Despite investing \$39 billion in the fourth quarter, private equity firms still have plenty of cash to invest. There was nearly \$452 billion of overhang in 2011, as firms piled up nearly \$13 billion more in 2011 than the prior year.
- Nonetheless, the number of funds raising capital during 2011 stood at 141, slightly ahead of the 138 funds in FY 2010.

DEAL VOLUME BY DEAL SIZE RANGE



- In FY 2011, the volume of deals in excess of \$2.5 billion increased as a larger percentage of total deal activity, reaching a level not seen since 2008. We continue to believe this activity will eventually flow to smaller sized deals in 2012.

DEAL VOLUME BY REGION



- The Midwest continues to lead the deal volume tables. Most regions saw only minor change from 2010

Candlewood Perspective

Candlewood Perspective:

Candlewood continues to experience an increase in activity across a wide range of industries, sizes, and types of transactions. Financial buyers are eager to investigate many types of potential investment opportunities and are getting creative in their deal structuring. On the other hand, our last four sell-side transactions went for aggressive multiples to strategic buyers. We are also seeing a small up-tick in sellers' interest in ESOP or related transactions where the shareholders can take out a meaningful distribution while rewarding the employee group for their loyalty and hard work. Clearly, when the debt markets cooperate, there are more options for sellers. As we continue to speak with professionals involved in transactions, many of them believe an up-tick is underway, and that includes Candlewood, as indicated in the transaction list below.

Active Candlewood Transactions

<u>Engagement Type</u>	<u>Industry</u>	<u>Company Description</u>	<u>Deal Stage</u>
Sell-Side	Industrial	Marine bearing and component manufacturer	Pre-marketing
Sell-Side	Industrial	Manufacturer of tire molds	Closing
Sell-Side	Healthcare	Institutional pharmacy	Closing
Sell-Side	Consumer	Value-add distributor of vending equipment	Seeking Buyers
Sell-Side	Industrial	Die cutting of industrial and consumer products	Pre-marketing
Financial Advisor	Education	On-line accredited university	Valuation
Buy-Side	Industrial	Civil construction firm acquiring electrical contractor	Negotiation
Capital Raise	Financial Services	Specialty finance company for real estate development	Seeking Investors
Capital Raise	Financial Services	Commercial cash advance lender	Seeking Lenders
Capital Raise	Infrastructure	Commercial real estate in the Philippines	Seeking Investors
Capital Raise	Infrastructure	Sludge containment and conversion	Seeking Investors
Capital Raise	Infrastructure	Container port in southern U.S.	Term Sheet
Capital Raise	Infrastructure	Algae to fuel processor	Seeking Investors

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