



## *First Quarter 2010*

### **Middle-Market Transaction Update**

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## **M&A Volumes Continue Rebound in Q4 '09** *Unemployment and Taxes Key Obstacles to Economy*

### **Q4 Spike in Deal Activity Closes Book on Turbulent 2009**

After starting out as one of the worst economic and M&A environments in recent memory, 2009 finished on a positive note with deal activity and transaction multiples extending their surge from Q3 '09. Deal activity jumped 90% from Q3 '09 for disclosed middle market transactions (Enterprise Value < \$500 million and > \$10 million). Pent up demand and improving economic dynamics appear to be driving the resurgence in M&A activity. Despite slowly improving credit markets, future deal volume growth will be limited due to an overall lack of financing and depressed 2009 earnings. Transaction multiples for Q4 '09 increased to 6.1x enterprise value to EBITDA compared to 5.8x for all of 2009 reflecting improving credit availability and buyers becoming more aggressive in the market. We anticipate improved deal volume for transactions greater than \$10 million EBITDA will be offset by continued stagnancy in smaller transactions where financing is still extremely limited.

### **Credit Still Restrained as Markets Slowly Begin to Unfreeze**

The credit markets are beginning to show signs of life as Q4 '09 activity far exceeded the previous three quarters combined. LBO loan volume for companies with EBITDA of \$50 million or less totaled \$720 million in Q4 '09 versus \$153 million for the first three quarters of 2009 combined. These figures compare to \$260 million in Q4 '08 and \$1.1 billion in Q4 '07. Despite the recent improvement, credit availability remains a significant challenge for the middle market. According to S&P, total debt-to-EBITDA was 3.3x for all of 2009 versus 4.3x for 2008. Senior debt multiples fell to 2.5x in 2009 compared to the 2008 average of 3.6x. Mezzanine multiples increased to 0.7x in 2009 versus 0.6x in 2008 partially offsetting the lack of traditional senior debt financing.

### **Strong Economic Indicators Mired by High Unemployment**

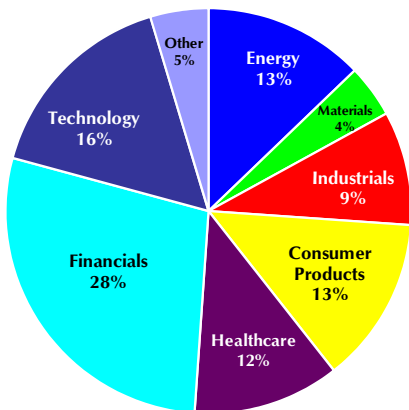
The U.S. economy continued its rebound expanding for the second consecutive quarter. According to preliminary estimates, the economy expanded at a seasonally adjusted rate of 5.7% in Q4 '09 compared to 2.2% in Q3 '09. While consumer spending, the housing markets and export growth all contributed, a 3.4% contribution from inventory expansion was the largest factor increasing GDP. Federal, state and local government spending fell in Q4 which was a positive sign that consumers and private industry were powering growth. The sustainability of future growth is a concern with inventory driven GDP as unemployment remained near 10% in January combined with stagnate consumer spending. The potential impact of the current Administration's \$3.8 trillion budget for fiscal 2011 that will increase the deficit by a record \$1.6 trillion despite staggering tax increases on businesses and upper-income households is a significant threat to private industry and future economic growth.

**TRANSACTION ENVIRONMENT**

**The Data**

**Deal Volume** – Middle market M&A deal activity in Q4 '09 made a dramatic leap from the previous three quarters in 2009. Middle market disclosed transactions (Enterprise Value < \$500 million and > \$10 million) increased 90% in Q4 '09 from Q3 '09. In addition, the total number of all M&A transactions increased 24% in Q4 '09 after increase 23% in the third quarter. Transactions in which value metrics are not disclosed (predominately smaller transactions within the middle-market) rose 22% in the fourth quarter reinforcing that M&A activity reached bottom in Q2 '09. As the credit markets gradually improve and economic trends remains positive, we anticipate Q1 '10 deal activity will most likely remain equal with Q4. Figure I highlights middle market deal volume by industry sector based on data from Capital IQ. Activity in the industrial sector has been hardest hit while the financial sector (primarily distressed transactions), health care and energy remain robust.

**Figure I**  
**U.S. Middle-Market Deal Statistics<sup>(1)</sup>**



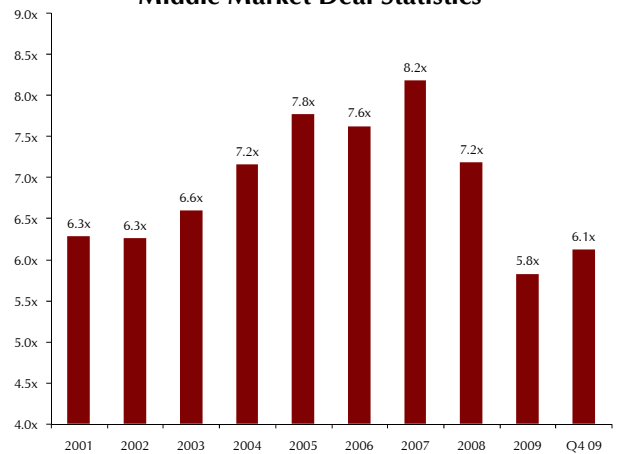
Source: Capital IQ  
(1) Middle market disclosed transactions (Enterprise Value < \$500 million and > \$10 million)

**Deal Value** – Aggregate deal value for middle market transactions nearly doubled during the fourth quarter after a 18% increase in Q3 '09. The increase is the result of a 90% increase in transaction activity during Q4 '09. Total deal value in the middle-market approximated \$36.8 billion in Q4 '09 compared to \$19.4 billion during Q3 '09 and \$16.4 billion in Q2 '09.

Within the middle market, the average transaction size increased 33% to \$82 million in Q4 '09 compared to \$61 million for Q3 '09 and \$72 million in Q2 '09. The overall trend reflects higher purchase price multiples and improving credit markets particularly for larger transactions.

**Transaction Multiples** – Middle market transaction multiples continued their positive trend in Q4 '09 increasing to 6.1x compared to 5.9x in Q3 '09 and 4.9x in Q2 '09. For the full year 2009, deal multiples averaged 5.8x as financing remained very limited in the middle market and distressed transactions were a significant portion of deals during most of the year. Relative to previous periods, multiples have fallen well below averages for the past three years with enterprise value/EBITDA multiples averaging 7.2x for 2008 compared to 8.2x for 2007 and 7.6x for 2006 (see Figure II). For 2010, we believe that multiples will gradually improve as the credit markets continue to slowly unfreeze for middle market transactions and overall economic conditions maintain a positive trend towards recovery.

**Figure II**  
**Middle-Market Deal Statistics<sup>(1)</sup>**



Source: WYCC Market Analysis  
(1) Transactions between \$10 and \$250 million with EV/EBITDA multiples < 15x; excludes technology, media and telecom

**MARKET DYNAMICS**

The fourth quarter of 2009 represented a marked improvement from earlier in the year when the recession and frozen credit markets put a strangle hold on M&A activity. Transaction volumes and purchase price multiples continued their positive trends in Q4 '09. Encouraging economic indicators from the recovering U.S. economy and noticeable signs of improving credit markets provides optimism that the M&A market will steadily improve throughout 2010. Future M&A activity will be predicated on the strength and sustainability of the economic recovery. Growth in the private sector, lower unemployment and Federal Reserve monetary policy will be critical in the months ahead. In addition, the potential for overwhelming tax increases on businesses and upper-income households is a significant threat to private industry and future economic growth. As a result, transaction volumes and multiples are expected to remain consistent with Q4 '09 as the economic recovery continues and as credit availability continues to slowly improve for the middle market.

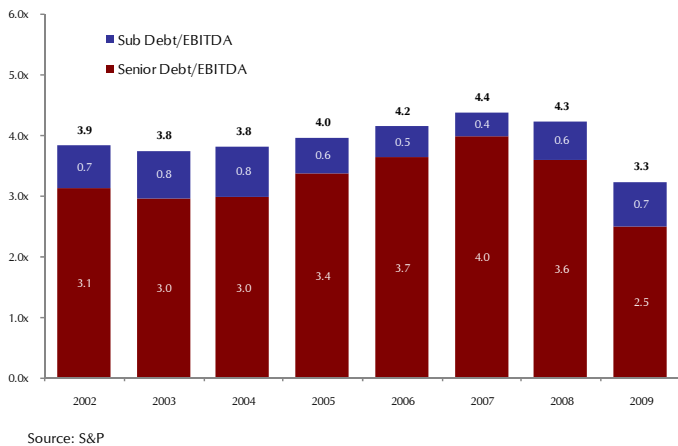
**AVAILABILITY OF CAPITAL**

**Debt Capital**

According to S&P, loan volume for issuers with less than \$50 million in EBITDA totaled \$2.5 billion in Q4 '09 compared to \$1.3 billion in Q3 '09 and \$0.5 billion in Q4 '08. The fourth quarter represented a dramatic improvement in credit availability since the market decline in early 2008. LBO loan volume also made substantial gains in Q4 '09 increasing to \$720 million compared to \$153 million for the first three quarters combined. As a result, transaction volumes rebounded dramatically in the fourth quarter combined with larger equity contributions along with greater utilization of mezzanine financing to offset the lack of senior debt availability. Subordinated debt and Other Senior debt combined increased to 0.7x during 2009 compared to 0.6x for fiscal year 2008.

As lenders continued to tighten credit standards and preserve capital, leverage multiples fell further from 2008 levels. As indicated in Figure III, senior debt-to-EBITDA declined to 2.5x in 2009, down 1.1x from 3.6x for fiscal year 2008. The increased utilization of non-traditional senior financing held total debt-to-EBITDA ratios at 3.3x in 2009 compared to 4.3x for all of 2008.

**Figure III**  
Average Credit Statistics of Middle Market LBO Transactions (EBITDA \$50 mm or less)

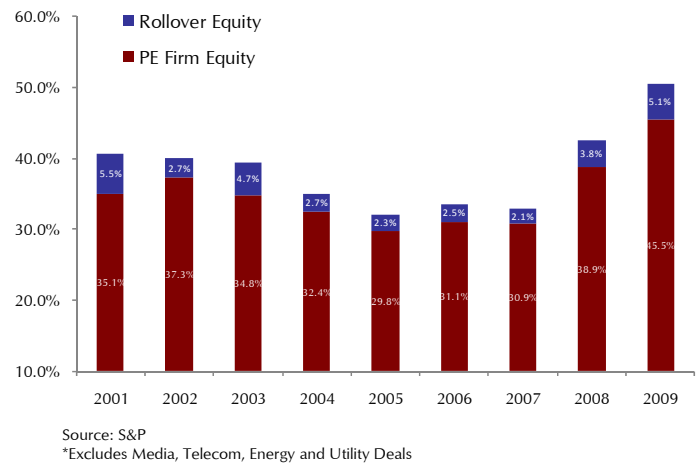


Consistent with previous periods, unlike larger transactions, highly leveraged lending within the middle market is restrained. While 10% of the large corporate transactions topped a debt-to-EBITDA ratio of 7.0x or greater in 2009, no middle market transactions reached 7.0x during 2009. For LBO transactions, neither large corporate nor middle market had an LBO transaction with a debt-to-EBITDA ratio of 7.0x or greater in 2009.

**Equity Capital**

To compensate for the dramatic decline in senior leverage ratios throughout 2008 and 2009, equity contributions increased over 50% from 2007 levels. S&P reported that the overall LBO equity contribution for deals with EBITDA of \$50 mm or less averaged 51% of the total capital structure in 2009, up from 43% for calendar year 2008 and 33% in 2007. As overall leverage declined and credit standards tightened, lenders began requiring much higher minimum equity contributions versus previous years. In addition, the increasing trend in equity contributions reflects the willingness of private equity to increase their percentage equity contribution in order to consummate deals (see Figure IV).

**Figure IV**  
Average LBO Equity Contribution Deals with EBITDA of \$50 mm or Less\*



**ECONOMIC FACTORS**

A significant rise in Q4 '09 GDP marks two consecutive quarters of growth after four consecutive quarters of contraction. Positive economic indicators in manufacturing and personal income reflect the economic recovery continues to gain momentum despite weakness in construction spending and persistently high unemployment. Stable inflation and commodity prices have been critical to supporting the fragile economy. A devaluation of the dollar, inflation or increased taxes could eventually disrupt the economic upturn.

- **Gross Domestic Product (GDP)** – According to the BEA’s advance estimates, real gross domestic product increased at a 5.7% annual rate during Q4 '09 compared with an increase 2.2% in the third quarter. The rise in GDP reflected the second consecutive quarter of growth after four straight quarters of contraction. Results were better than the private sector forecasted increase of 4.8%. The GDP gain was driven

by a 3.4% contribution from inventory expansion. Minus the inventory expansion, real final sales rose by 2.2% up from 1.5% in the third quarter. Federal, state and local government spending fell 0.2% after increasing 7.9% in Q3 '09 suggesting the economy's growth last quarter was primarily from consumers and private industry. Equipment investment rose 13.3% in Q4 '09 contributing 0.8% to GDP, the highest since Q1 '06. Real exports of goods and services increased 18.1% in the fourth quarter compared to a decrease of 5.9% in the third quarter. Real personal consumption expenditures increased 2.0% in the fourth quarter versus an increase of 2.8% in the third quarter.

- **Inflation** – On a seasonally adjusted basis, the December CPI Index rose 0.1% compared to a 0.4% increase in November. Over the last twelve months, the CPI Index increased 2.7% before seasonal adjustment compared to 0.1% in 2008. The larger increase in 2009 was primarily due to the energy index, which rose 18.2% during 2009 after falling 21.3% in 2008. The index for all items less food and energy rose 1.8% during 2009. In December 2009, the food index rose 0.2%, its largest one month advance in over a year. While the energy index also increased 0.2%, it was its lowest increase in five months. The indexes for fuel oil and gasoline rose, but the electricity index was unchanged and the natural gas index declined.
- **New Housing** – New home construction fell in December, however building permits increased providing evidence the housing market may regain momentum after the run up and subsequent falloff from buyers taking advantage of tax credits that were set to expire. Housing starts decreased 4% in December to a 557,000 seasonally adjusted rate. Single family housing starts fell 6.9% to a rate of 456,000 in December. Construction of single-family homes declined 11.1% to 503,000 and building permits for single-family homes increased 8.3% to 508,000.
- **Employment** – The U.S. unemployment rate unexpectedly declined in January to 9.7% from 10% in December 2009 despite the economy continuing to shed jobs. In January, nonfarm payrolls fell by 20,000, however unemployed persons decreased to 14.8 million (6.3 million jobless for 27 weeks and over). A measure of unemployment that includes people who have stopped actively searching for work or are working part-

time because they are unable to find full-time work fell to 16.5% in January from 17.3% in December. Since the start of the recession in December 2007, payroll employment has fallen by 8.4 million. In January, manufacturing added jobs for the first time since November 2007 with a gain of 11,000 jobs while construction employment lost 75,000 jobs. Healthcare employment increased by 15,000 jobs and temporary help services added 52,000 jobs in January.

- **Consumer Confidence** – According to the Reuters/University of Michigan Index of Consumer Sentiment, consumer confidence rose in January to its highest level in two years due to a more favorable outlook for the national economy. Despite the expected gains in the economy, consumers still anticipate no improvement in their overall personal financial situation. The Index of Consumer Sentiment was 74.4 in the January 2010 survey, up from 72.5 in December and well above last December's 61.2. In the January survey, more consumers anticipated stagnating incomes rather than expected improved finances. The proportion of households who reported that their finances had worsened fell slightly to 45% in January, down from 49% in December. 56% of all households anticipated no net income increase in the year ahead.

## CONCLUSION

Although a significant portion of the economic growth during the fourth quarter was driven by inventory expansion, the underlying economic indicators reflect the economy continues to stabilize and improve in several areas. Consumers and private industry appear to be fueling the recovery in the fourth quarter compared to government spending in the third quarter which significantly enhances the sustainability of the recovery. Weak construction spending, persistently high unemployment and tight credit markets will ultimately weigh on the pace of the recovery as inventory expansion slows. In addition, the timing of when the Federal Reserve decides to begin reigning in the unprecedented monetary stimulus will be crucial for maintaining the current recovery. We anticipate M&A activity in the first half of 2010 will remain at levels consistent with Q4 '09 as pent up demand comes to market. Growth beyond current levels will require continued improvement in the credit markets and further evidence of a sustainable recovery such as lower unemployment rates in the second half of 2010.

W. Y. Campbell & Company is one the country's leading providers of middle-market merger advice, serving both public and privately-held corporations, as well as private equity firms since 1988.

## RECENT TRANSACTIONS



**Quinton Hazell Group**  
a subsidiary of



**AFFINIA**  
has been acquired by

**Klarius**

**Klarius Group Limited**

*The undersigned acted as exclusive financial advisor to Affinia Group Inc. in the above transaction.*

**W. Y. CAMPBELL & COMPANY**




February, 2010

In February 2010, Quinton Hazell, a subsidiary of Affinia Group Inc., was sold to Klarius Group Limited. W.Y. Campbell & Company acted as the exclusive investment banking advisor to Affinia in managing this sale process.

Quinton Hazell designs, manufactures, markets, & distributes a broad range of aftermarket replacement components for the Europe motor vehicle market. The company's products comprise steering & suspension, timing & tensioners, shocks, pumps (water and fuel), brake rotors, clutch, brake friction, wheel bearing kits, rotating electrics, filters, and other various components. The company is based in Hinckley, Warwickshire (UK).

Klarius Group Limited is a privately owned manufacturer of exhaust systems. Based in Blackpool, Lancashire (UK), Klarius offers exhaust systems, catalytic converters, Lambda sensors, diesel particulate filters and shock absorbers for all types of vehicle applications primarily for the European independent aftermarket.

Affinia Group Inc. is a leader in the design, manufacture, distribution and marketing of industrial grade products and services, including extensive offerings of aftermarket parts for automotive and heavy-duty vehicles. With more than \$1.8 billion in annual revenue Affinia has operations in North and South America. Europe. Asia and India.



**Prestolite Electric Holding (China) LLC**


\$33,500,000 Convertible Loan  
provided by

**DARBY**  
PRIVATE EQUITY  
FRANKLIN TEMPLETON  
INVESTMENTS

*The undersigned acted as exclusive financial advisor to Prestolite Electric Incorporated in the above transaction.*

**W. Y. CAMPBELL & COMPANY**

December, 2009



In December 2009, Prestolite Electric Holding (China) LLC, the holding company for Prestolite Electric, Inc.'s ownership interest in its China-based joint venture, issued a \$33.5 million convertible loan to an Asia-focused mezzanine fund managed by an affiliate of Darby Overseas Investments, Ltd. W.Y. Campbell & Company acted as the exclusive investment banking advisor to Prestolite.

Prestolite Electric Beijing Ltd. (China) designs, manufactures, and sells a full-line of medium & heavy duty alternators and starter motors to both OEMs and the aftermarket. The company is the largest supplier of alternators to both the Chinese truck & bus market. Prestolite Electric Incorporated, based in Plymouth, MI is a leading global manufacturer of alternators & starter motors sold into the medium & heavy duty vehicle, military, and industrial markets.

Prestolite is owned by First Atlantic Capital, a New York based private equity firm that has invested over \$830 million across four funds.

Darby Overseas Investments, Ltd., the private equity arm of Franklin Templeton Investments, is an emerging markets private equity firm with over a decade of experience and over 50 seasoned investment professionals in 13 offices worldwide.

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