

Middle Market M&A Review

Second Quarter 2008

Volume Q2 2008

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Elliott Davis Capital Partners is a regional investment banking firm providing a complete range of services including:

- Merger and Acquisition Advice
- Private Capital Raising
- Restructurings
- Recapitalization
- Corporate Advisory Services

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Elliott Davis Capital Partners, LLC - Second Quarter 2008 Newsletter

Welcome to the Elliott Davis Capital Partners Second Quarter 2008 Update. It has been a tough first quarter for almost everyone, with the financial sector probably hit the hardest. The economic challenges of the last six months, whether real or perceived, continue to affect middle market M&A transactions with volume decreasing by 18% over the first quarter of 2007. Even more surprising was that just seven of the forty-nine industries tracked by FactSet MergerStat posted an increase in deal volume over the first quarter of 2007.

This decrease in transaction volume was primarily driven by a reduction in available credit and talks of slowdown/recession in the economy. Despite the well publicized volatility in the capital and financial markets on Wall Street, we believe that the decrease in activity in the lower middle market (i.e. Main Street) has not been as great and will stabilize in the near future. According to Thompson Financial, private equity funds raised \$302 billion during 2007, a \$47 billion increase from 2006. Although the debt markets have contracted, this available capital will eventually be deployed. Accordingly, we should see a return in buy-out activity towards the end of the year or early 2009 as the credit market stabilizes. However, we will probably see a decrease in valuations or more conservative deal structures, at least in the initial stages of the recovery.

Private equity buyers have competed head-to-head with strategic or corporate buyers over the past couple of years (driving up valuations in the process), but the tightening credit market may have paved the way for a wave of strategic deals. As such, strategic buyers, armed with strong balance sheets and excess cash, may be hunting for more deals during the remainder of 2008. We will have to wait and see how this unfolds over the next couple of months.

We still believe that the core drivers of activity in the lower middle market, including the record availability of equity capital, the desire of baby boomers to cash out, and a closing capital gains tax window, remain unchanged. Though overall valuation multiples may decline in concert with the decrease in leverage multiples, it is unlikely the decline will precipitate a dramatic decrease in transaction volumes in the lower middle-market.

Working predominantly with privately-held businesses, the professionals of Elliott Davis Capital Partners recognize that the decision to raise capital or sell a company is a difficult one to make. Specifically, owners need to understand the benefits and disadvantages of these decisions, as well as the impact they can have on a business. Working together with the tax, estate and wealth management professionals of Elliott Davis, Elliott Davis Capital Partners is uniquely positioned to help clients decipher the increasing complexities their businesses face. We hope you find this newsletter informative and will not hesitate to give us a call to answer any questions you may have.

Sincerely,

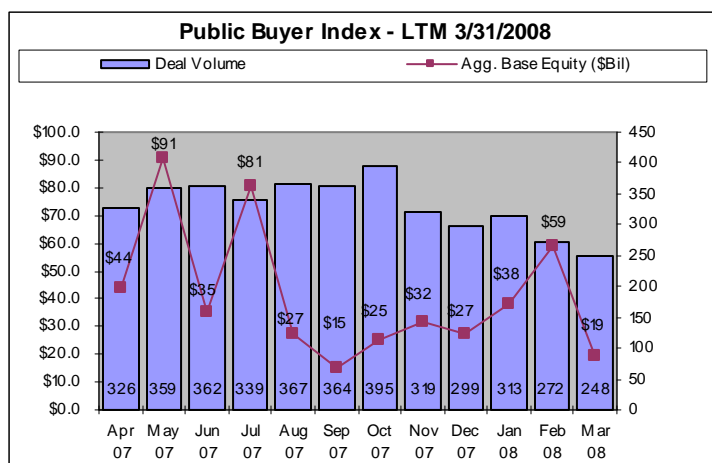
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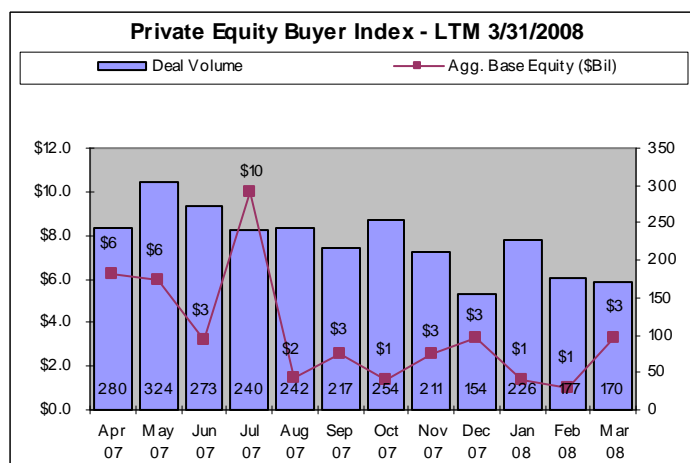
Middle Market Transaction Update and Overview

US Lower Middle Market M&A Transaction Metrics						
Deal Size (\$ mm)	Number of Transactions			Aggregate Base Equity (\$ mm)		
	TTM Ended			TTM Ended		
	3/31/08	3/31/07	Change	3/31/08	3/31/07	Change
\$100 - \$250	390	483	-19%	\$62,100	\$77,100	-19%
\$50 - \$100	446	467	-4%	\$31,100	\$32,500	-4%
\$25 - \$50	453	545	-17%	\$16,200	\$19,400	-16%
\$10 - \$25	522	673	-22%	\$8,500	\$10,800	-21%
Under \$10	814	1,032	-21%	\$3,500	\$4,300	-19%
Total	2,625	3,200	-18%	\$121,400	\$144,100	-16%

Source: FactSet MergerStat



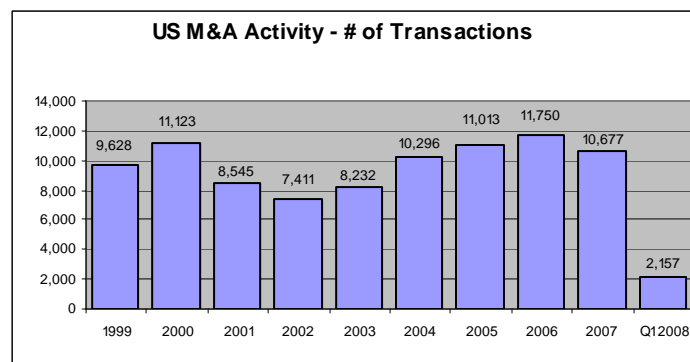
Source: FactSet MergerStat



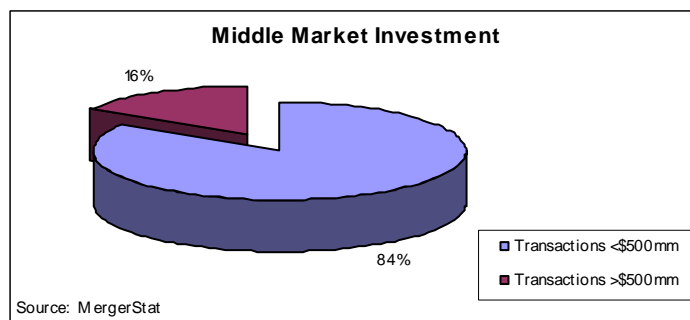
Source: FactSet MergerStat

Highlights

- For the TTM ended 3/31/2008, transaction activity under \$250 million was down 18% when compared to the strong deal activity over the same period in 2007. Total transaction values were lower by 16% as larger deals pushed aggregate M&A dollar volumes up to compensate for lower activity.
- Activity by Private Equity buyers slowed, resulting in December, February and March being the slowest months over the last twelve month period. M&A spending by PE buyers sank to its second lowest level in the past 12 months. Most of this can be explained by the ongoing turmoil in the credit markets, economic slowdown and fears of a recession.
- Middle market M&A investment activity (i.e. transactions less than \$500 million) continues to dominate the M&A market, representing approximately 84% of all transactions.
- The tables on page 4 indicate that both EBITDA valuation multiples, as well as leverage multiples for middle-market M&A are down slightly compared to 2007 and prior years; again most of this can be explained by the ongoing turmoil in the credit markets, economic slowdown and fears of a recession.



Source: MergerStat



Source: MergerStat

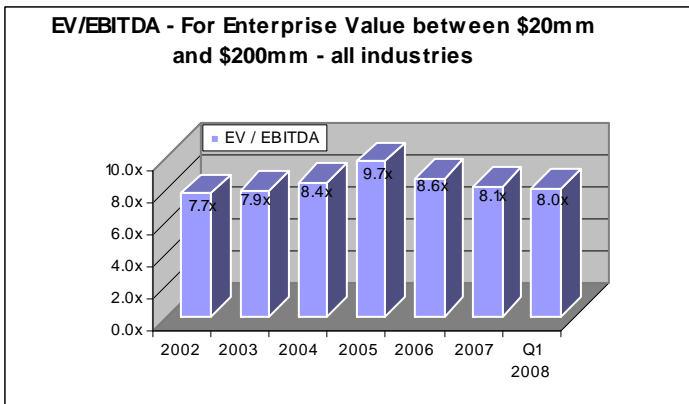
M&A Transaction Deal Volume and Valuation Statistics

A company's value is usually determined by its financial performance, relevant benchmark industry financial performance, capital expenditure intensity as well as numerous other external, non-controllable factors, such as the industry in which it operates, current economic conditions, restrictive regulations and relevant M&A activity. Strategic buyers are sometimes willing to pay significant premiums due to product and/or other synergies. These factors result in valuations that often vary significantly from company to company, even in the same industry. As such, average EBITDA multiples can be a bit misleading. Nonetheless, averages can help provide a meaningful historical perspective for business owners and their advisors. The following table outlines the deal volume for a wide range of industries as well as the range in average EBITDA multiples for these industries. The multiples are often skewed toward the higher end due to larger value deals with higher multiples. In general, lower middle market deals, that is, deals with transaction values less than \$50 million, tend not to be at the higher end of the range.

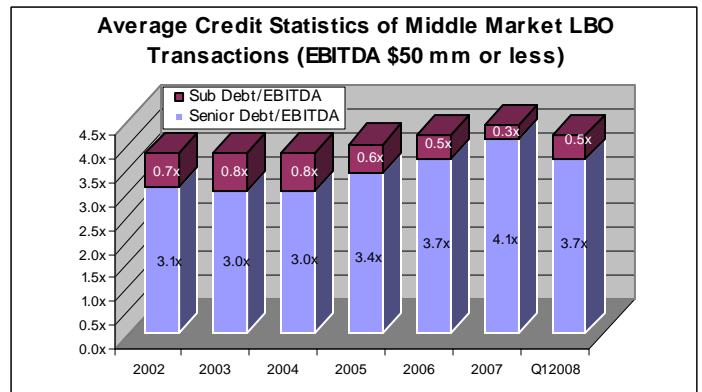
Industry by Activity - Deal Count - 3/31/2008								
Industry	Deal Count		Diff	52 Week Average	# Deals Reporting EBITDA	24 Month Multiple		
	TTM 3/31/2008	LTM 3/31/2007		EBITDA Multiple		Hi	Low	
Aerospace, Aircraft & Defence	40	49	-9	N/A	N/A	N/A	N/A	N/A
Agricultural Production	53	67	-14	N/A	N/A	N/A	N/A	N/A
Apparel	62	85	-23	13.05	5	20.02	6.67	
Automotive Products & Accessories	68	68	0	9.3	3	10.3	3.1	
Autos & Trucks	18	39	-21	N/A	N/A	N/A	N/A	N/A
Banking & Finance	311	468	-157	N/A	N/A	N/A	N/A	N/A
Beverages	60	69	-9	N/A	N/A	N/A	N/A	N/A
Broadcasting	121	476	-355	11.54	3	15.74	2.67	
Brokerage, Investment & Mgmt. Consulting	681	637	44	15.84	24	37.63	1.25	
Building Products	17	24	-7	N/A	N/A	N/A	N/A	N/A
Chemicals, Paints & Coatings	188	226	-38	7.25	4	14.53	4.38	
Communications	212	255	-43	9.83	12	38.97	1.04	
Computer Software, Supplies & Services	1,580	1,668	-88	17.89	33	45.08	3.81	
Construction Contractors & Eng. Services	490	453	37	6.39	4	17.60	4.25	
Drugs, Medical Supplies & Equipment	360	357	3	21.07	26	47.09	1.63	
Electric, Gas Water & Sanitary Services	165	237	-72	9.80	4	23.58	6.02	
Electrical Equipment	201	185	16	12.03	5	14.41	0.21	
Electronics	190	192	-2	13.21	8	34.12	3.80	
Energy Services	126	149	-23	9.64	4	24.86	4.01	
Fabricated Metal Products	148	148	0	9.47	5	12.94	4.78	
Food Processing	141	162	-21	11.65	3	18.96	6.20	
Furniture	47	30	17	N/A	N/A	N/A	N/A	N/A
Health Services	289	345	-56	15.95	11	48.36	4.49	
Household Goods	48	61	-13	15.1	5	44.3	0.0	
Industrial & Farm Equipment & Machinery	186	230	-44	N/A	N/A	N/A	N/A	N/A
Instruments & Photographic Equipment	140	184	-44	19.42	8	35.92	2.06	
Leisure & Entertainment	425	607	-182	14.68	17	40.54	1.89	
Miscellaneous Manufacturing	53	54	-1	12.58	3	15.05	10.77	
Miscellaneous Services	1,171	1,392	-221	13.78	15	28.87	0.05	
Office Equipment & Computer Hardware	75	76	-1	10.79	6	24.54	4.58	
Oil & Gas	92	100	-8	15.64	4	28.53	5.15	
Packaging and Containers	11	16	-5	N/A	N/A	N/A	N/A	N/A
Paper	62	71	-9	N/A	N/A	N/A	N/A	N/A
Plastics & Rubber	83	112	-29	9.59	3	22.29	3.28	
Primary Metal Processing	85	119	-34	7.52	3	12.65	2.38	
Printing & Publishing	216	305	-89	19.29	5	31.39	5.05	
Real Estate	130	170	-40	17.7	5	31.39	5.05	
Retail	329	400	-71	11.58	13	33.45	4.16	
Stone, Clay & Glass	78	94	-16	18.21	3	32.58	10.07	
Textiles	28	40	-12	N/A	N/A	N/A	N/A	N/A
Timber & Forestry	28	33	-5	N/A	N/A	N/A	N/A	N/A
Toiletries & Cosmetics	20	19	1	N/A	N/A	N/A	N/A	N/A
Toys & Recreational Products	52	61	-9	11.45	3	16.00	6.24	
Transportation	149	158	-9	15.38	5	45.85	2.05	
Valves, Pumps & Hydraulics	29	19	10	N/A	N/A	N/A	N/A	N/A
Wholesale & Distribution	474	588	-114	12.24	13	43.49	1.66	
	9,532	11,298	-1,766					

Source: FactSet MergerStat

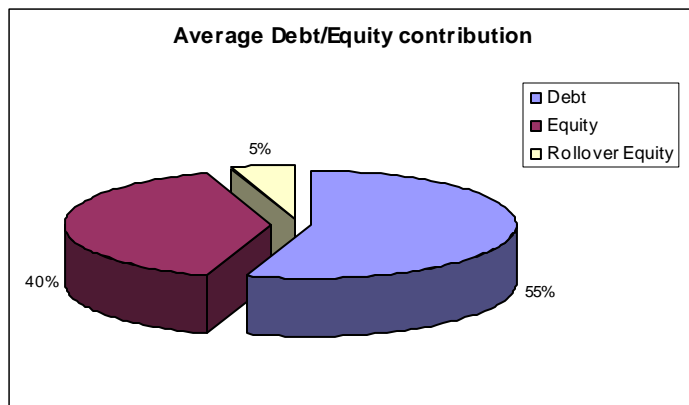
Valuation, Deal Structure and Leading Middle Market Industries Statistics



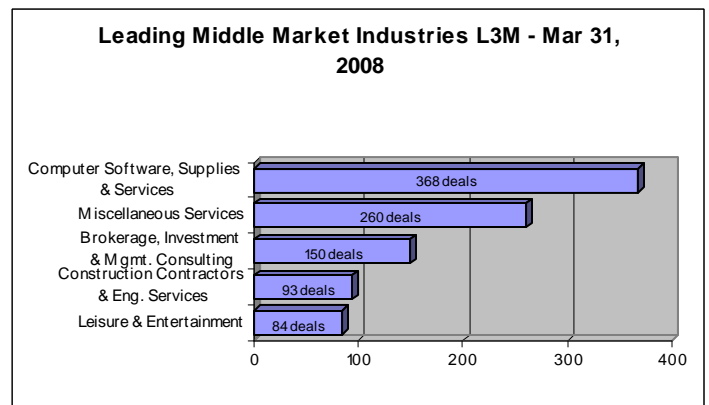
Source: FactSet MergerStat



Source: S&P



Source: Capital IQ



Source: FactSet MergerStat

Current Economic Conditions

There is a saying on Wall Street: "As January goes, so goes the year." Needless to say, January was not good; in fact, it was horrible. Financial markets were on a bumpy downhill slide during the first quarter of 2008 and there were more than a few factors contributing to the Q1 decline, including a weak dollar, skyrocketing oil and food prices, higher unemployment rates, a nose diving residential housing market, tight credit conditions, mortgage company bankruptcy filings, the chaos surrounding the collapse of Bear Stearns followed by the Federal Reserve bail-out, and 225 basis points of Federal Reserve rate cuts from 4.25% in January to 2% by April 30, 2008.

On April 30 2008, following a scheduled meeting by the Federal Open Market Committee ("FOMC"), the Federal Reserve announced that "recent information indicates that economic activity remains weak. Household and business spending has been subdued and labor markets have softened further. Financial markets remain under considerable stress, and tight credit conditions and the deepening housing contraction are likely to weigh on economic growth over the next few quarters".

To compensate for all the bad news of Q1 2008, the second quarter got off to a great start when IBM, Google, Intel, eBay and several other technology companies announce increased earnings and profits compared to the same period in 2007. Even the bruised and battered financial giants like Wells Fargo and J.P. Morgan posted solid Q1 2008 results, despite the ongoing credit crises. We still believe it is not all doom and gloom out there, although it is definitely not close to the heady times we experienced from 2004 to late into 2007. The latest earnings releases are encouraging for the markets and hopefully will overshadow the negative, yet carefully worded, comments from the Federal Reserve on regional economic conditions and the 17-year-low of new housing starts.

To contain inflation, the Federal Reserve is probably finished with rate cuts for 2008, with future rate hikes possible later in the year, depending on incoming inflation numbers. The hope is that all these rate cuts would restore some confidence in the financial markets and U.S. economy. In the coming months we will monitor the relevant M&A deal volume to learn how the latest economic conditions may impact the middle-market M&A environment for the remainder of 2008 and will continue to provide updates to our readers.

Preparing your Company for a Sale

All owners will exit their businesses at some point in time, whether through a transfer of ownership to family or management, or through a sale to an outside party. For most owners, this transition is the single most important event of their professional lives as it represents the culmination of many years of financial and emotional commitment. In our last newsletter, we discussed the factors that business owners should consider on a personal level prior to the sale of their businesses. In this article, we will discuss the preparation of the company for sale. It is important that a business owner preemptively addresses the buyer's anticipated concerns; namely, reducing the risks associated with continuity of sales, accuracy of financial reporting, stability of operations, and legal compliance. Some of these steps will have an immediate positive impact on the business, regardless of when it is actually sold.

What makes your business unique? Why do your employees and customers choose your business over those of your competitors? We recommend answering these in the form of a concise business plan, prepared with the assistance of an experienced investment banker. This plan should include a description of your operations, competitive advantages, an evaluation of current and future opportunities within your industry, customer statistics, financial projections and growth plans, including milestones by which you intend to gauge your business's performance. This document will serve as both a deliverable item to potential investors or buyers, as well as a jumping-off point for thinking about many of the actions described below.

A buyer may have many reasons to purchase a business, but for most mature target companies, the purchase price should reflect the value of a company's future normalized earnings, at today's value, adjusted for risk. By this rationale, anything a seller can do to ensure the continuity of sales (and the resulting earnings), will make the business instantly more attractive. We often hear unease about customer concentration – that is, how severely would your sales (and ultimately, earnings) be affected by the loss of any particular customer? While it is important to retain key customers, it is also important to reduce this risk by diversifying your customer base. Similarly, is your business significantly affected by seasonality or cyclicalities? What hedging activity can be undertaken to reduce the variability in your revenue? We advise developing several other metrics by which you can measure your sales over time and in relation to your industry. Remember also to evaluate any distinct projects or business segments and to discontinue any “pet” projects, or those that do not have any expected value going forward. Finally, is it possible to turn any informal “hand-shake” agreements with customers into long-term contracts with clear pricing, duration, and termination clauses? Any such agreements will reduce the anxiety of a buyer who envisions a post-purchase customer retention nightmare scenario.

A company's finances are another area of interest to a potential buyer. While the sales may be real and the customers may be tangible, how reliable are the financial statements? Of what quality are the earnings? In presenting your company's finances to a buyer, the goal is to produce high quality, independently verifiable financial statements (cash flow, income, and balance sheet prepared in accordance with generally accepted accounting principles, or GAAP), for at least the last three years that are free of questionable items and represent an accurate picture of the company's actual fiscal health. To this end, we first recommend meeting with your firm's accountant. Next, consider moving to a widely-used electronic accounting system (i.e. QuickBooks or Peachtree Accounting), retaining an independent auditor to review your financial statements, remove any personal expenses from your books, and disclose other significant non-recurring items reflected in earnings. Finally, in advance of the sale, a proper capital structure (balance of debt and equity financing) may attract more potential buyers, but this structuring can be a challenging task, best undertaken under the guidance of a financial professional.

Those buyers who see a target business as a going concern will be understandably preoccupied with business continuity under new management. The integrity of the company's current management and operations is the best indication of its ability to continue operating profitably. We recommend that owners first put their own “houses” in order by creating an organization chart, complete with each employee's job description. Use the organization chart to think about who would be the successor if/when you are planning to retire. It is imperative that the buyer feel certain that the business can survive without your leadership. Develop a continuity plan so that unforeseen events will have minimal impact on your business's operations. Review employment contracts, demographic information, and salary history to ensure that all employee data are up-to-date. Operating manuals for any software, hardware, or machinery should be updated, catalogued, and accessible.

It would also be a good idea to start your preparation for the due diligence phase of the sales process. This will show the buyer that not only are you and your business prepared and well organized, but it may also indicate potential areas that require additional preparation. In this phase, the buyer works to discover all the pertinent information regarding the seller's business. All financial, sales, operating, and legal documents will be analyzed to both determine any risks facing the buyer, as well as to determine a fair offering price. In addition to preparing the documents and undertaking the actions recommended above, we also strongly advise retaining legal counsel to create legally-binding, defensible contracts for those informal areas of your business. Some suggestions are customer pricing contracts for sales and services, employee contracts, management non-compete contracts, lease contracts (whether you are the tenant or landlord), and long-term agreements with your vendors. Request that your legal counsel verify the accuracy of all legal, regulatory, licensing, and compliance paperwork and to ensure that these documents are properly filed with the proper entities.

Preparing your business for sale is an extended, arduous process. However, each step you take will not only make your business more attractive to a buyer, but will help to improve operations on an ongoing basis. We hope that you have found this short article helpful as you consider preparing your business for sale. Elliott Davis Capital Partners is ready to assist you with your business transition needs. As part of the Elliott Davis team, we can work together with the accounting and tax advisory services Elliott Davis offers to prepare your business for sale, while providing the expertise to assist you with the transaction itself.

ElliottDavis

Capital Partners

About us

Elliott Davis Capital Partners is a regional investment banking firm providing merger and acquisition, private placement, restructuring and corporate advisory services. We are focused on closely-held, mid-sized companies and their investors. For transactions involving these companies and their stakeholders, it is critical to bring investment banking, tax advisory and wealth management capabilities together as part of a single, cohesive team so that our client's objectives are met at the best possible terms.

Elliott Davis, one of the most respected professional service firms in the Southeast, complements our investment banking expertise and shares our commitment to client service.

The principals of Elliott Davis Capital Partners have transaction experience in a variety of industries including healthcare, manufacturing, distribution, retail, and information technology. Our experience ranges from start-up companies to public entities with enterprise values in excess of \$500 million. Depending on the service provided, Elliott Davis Capital Partners targets the following size transactions, but we will meet with any prospect regardless of industry or size to determine if we can be of service:

Merger & Acquisitions

- Assisting our clients with merger and acquisition services is at the heart of our practice, and we specialize in transactions involving companies with enterprise values in excess of \$15 million.

Private Placements

- Companies seeking to raise \$5 million or more in equity capital and/or raise or refinance \$10 million or more in debt or mezzanine capital.

"We understand the unique needs of closely held companies"

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"It is critical to bring investment banking, tax advisory and wealth management capabilities together as part of a single, cohesive team"

Our Role as Your Investment Banker

Our role as Investment Banker can be summarized by the following categories:

- **Provide M&A, Private Placement, Restructuring or Corporate Advisory Services**
We help position your company for a sale or private placement and will assist in the initial valuation of your company. As investment bankers we will also prepare the selling materials (Private Placement Memorandum, financial model, etc.) that will be provided to potential buyers or investors. As a team, Elliott Davis Capital Partners brings professional credibility to the process.
 - **Maximize Management's Time and Focus**
The sale or private placement process is very demanding of management's time. As your banker we will take on much of this workload so that you, as management, can continue to focus on what you do best—running your business!
 - **Introduce New Buyers or Investors and Maintain Confidentiality**
Often the eventual buyer or investor is unknown at the beginning of the sale or private placement process. As bankers we will present your company to a range of attractive buyers or investors. We do this in a very discreet and confidential way, therefore protecting the interests of your employees and clients/customers. As your banker we also require potential buyers or investors to reach the applicable agreements before sensitive information is released.
 - **Drive the Sales Process, Negotiate and Evaluate Bids**
To maximize value for you and your company, we create a competitive atmosphere and prepare the appropriate timeline for the transaction. We manage potential acquirers or investors to ensure a timely close is achieved. In addition, we also negotiate the terms of the transaction on behalf of our clients and serve as a buffer ("the bad guy") in investor negotiations when appropriate.
 - **Maximizes Value to the Seller**
Our primary goal is to maximize value through achieving the financial and non-financial objectives of the seller under the best possible terms.
-