

Market Observations as of Oct. 30, 2009

Q3 2009 M&A and Capital Markets – Global Activity

- WORLDWIDE M&A DOWN 38.2%, DEALS DOWN 11%** – The value of worldwide mergers and acquisitions totaled \$1.5 trillion for the first nine months of 2009, a 38.2% decrease over 2008 levels and the slowest first nine month period for M&A since 2004. By number of deals, M&A activity is down just 10.9% compared to last year with over 27,000 announced deals.
 - With \$461 billion in M&A announced for the quarter, dealmaking had the lowest third quarter figure since 2004.
 - Financial sponsor activity meanwhile has reached a 4-quarter high of \$37.9 billion for Q3, a marked increase over Q2 but down 67% on a full year basis. Financial sponsor activity has comprised just 4.9% of overall M&A activity so far in 2009, the lowest share since 2000.
- GLOBAL EQUITY CAPITAL MARKETS ACTIVITY UP 5%.**
- GLOBAL DEBT CAPITAL MARKETS ACTIVITY UP 21%.**
- WORLDWIDE STATUS/OUTLOOK** – Despite low M&A and syndicated loan volumes, bond markets remain very strong with record issuance in some asset classes. Follow on offerings continue to drive equity capital markets and there are signs of resurgence in the IPO market.
 - Worldwide total M&A dollar volume has contracted significantly when compared to Q1-Q3 2008, although the decline in the number of all M&A deals announced worldwide is just 11%, implying that bankers are active yet unable to close large mandates due to a lack of market confidence and difficulty financing large deals.
 - With the current lack of liquidity in capital markets, spinoffs are back in vogue as a desirable corporate strategy—and 2010 may see a wave of activity, especially since **private equity's overhang remains significant (\$400 billion)**, and as valuations stabilize, expectations solidify, and credit markets continue to thaw.

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M&A Activity Outlook

Don O'Connor

Managing Director

781.239.2900 x12

doconnor@tullyandholland.com

60 William St.

Suite 100

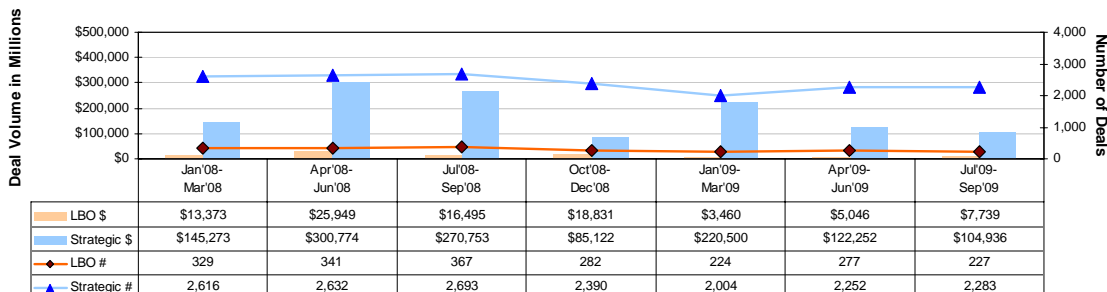
Wellesley, MA 02481

tullyandholland.com

M&A Activity by Quarter – North American Targets

- In Q1-Q3 of 2009, M&A volume involving North American targets was \$463.9 billion, down 60% from the first nine months of 2008.

North American Targets — Strategic vs. Financial Buyer M&A



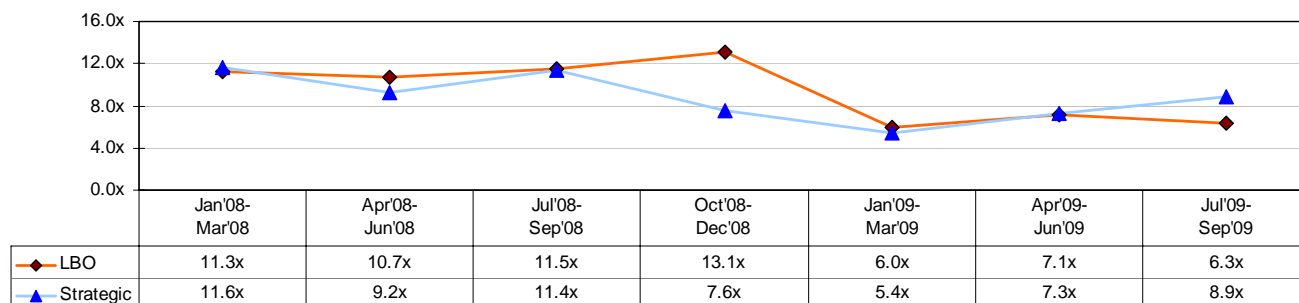
Source: Capital IQ

- The most recent AM&AA survey of its members sheds light on **private sector middle market M&A activity**. AM&AA's survey is focused on **private transactions less than \$100 million in deal size**. Their findings conflict with those reported in the prior Global section where the total number of M&A transactions was down less than the dollar volume. In the private sector, as reported by the AM&AA, the reverse is true.
 - Total M&A transactions completed **among private companies and less than \$100 million in deal size**, as reported in AM&AA's survey, were down 58% in the first half of 2009 compared to the first half of 2008.
 - Dollar volume of M&A transactions **among private companies and less than \$100 million in deal size**, as reported in AM&AA's survey, was down only 12% in the first half of 2009 compared to the first half of 2008, due to an increase in average transaction size.
 - **For private transactions less than \$100 million in deal size**, as reported in AM&AA's survey, the **average deal size increased 73% to \$13.5 million** in the first half of 2009, compared to \$7.8 million in the first half of 2008. According to AM&AA, this increase in transaction size indicates that **in this lower middle market, the current credit environment has impacted smaller deals more than larger deals**.

M&A Valuation by Quarter – North American Targets

- A rebound for M&A activity and valuation requires two ingredients, and both could be present in Q4 2009 and 2010 in many industries. First, buyers need financing. We've only recently seen signs that the debt market is coming back, which should further boost deal valuation multiples. Also, buyers need to be able to confidently predict the profits of the companies they want to acquire. This has been difficult in a declining economy.

North American Targets — Median Enterprise Value / EBITDA

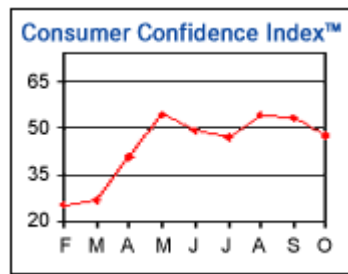


Source: Capital IQ

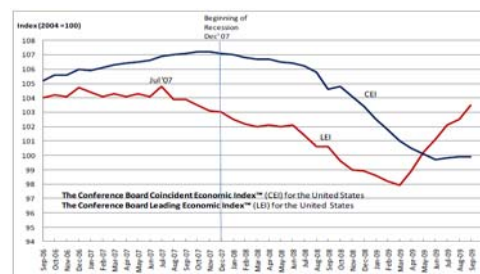
- The stock market rallied from March to October on hopes the economy had stopped its slide and corporate profits had begun to stabilize. The S&P 500, DJIA and NASDAQ Composite indices have risen 58.4%, 50.7%, and 68.6% vs. their March lows. But, employment, a lagging indicator, is likely to decline for at least several more months (i.e., beyond the fourth quarter holidays), which has raised worries the economic pain isn't over.
- Though LBOs may require greater equity investments today, the idea is to lever up once the debt market eventually loosens, which it is slowly starting to do. For all of the pain, private equity firms that can pull off acquisitions might look back at 2008 and 2009, with their cheap valuations, as signature vintages for buyouts.
- According to the AM&AA's abovementioned most recent survey on private sector middle market M&A activity, **the average private sector transaction multiple reported across all industries was 4.69x EBITDA**.
- Lower middle market companies and small businesses have experienced a tough deal climate in the last 12 months, according to a spokesperson for AM&AA, the group that conducted the survey, who added, "It was a difficult time period for financing transactions, and many decided to wait for a better economic climate before entering or re-entering the market. **We're hopeful that the \$400 billion overhang of capital that has built up in private equity groups will soon begin to assert itself in this market, and we may be seeing some early signs that this is starting to happen.** Next year's survey should tell the tale."

U.S. Economy Began to Grow in Q3, But How Sustainable is this Growth?

- U.S. GDP grew at a 3.5% annual rate in Q3, faster than economists expected, according to preliminary figures from the Bureau of Economic Analysis. Even so, it will be months before job-seekers begin to feel the benefits.
- A disappointing consumer spending report released on the following day, October 30, reinforced fears that the recovery would be slow and halting. The housing recovery and consumer spending cannot be sustained without growth of jobs and incomes. Inflation is mild.
- U.S. retail sales dropped 1.5% in September after the government's cash-for-clunkers subsidy ended, while sales excluding autos rose at a healthy pace. It was the largest decline in seasonally adjusted retail sales since December. In September, sales of motor vehicles dropped 10.4%, the largest decline in four years, more than reversing a 7.3% gain in August. Excluding autos, sales rose 0.5% in September.
- The Conference Board Consumer Confidence Index[®], which had declined in September, deteriorated further in October.



Source: The Conference Board



Source: The Conference Board

- The Conference Board Leading Economic Index™ (LEI) for the U.S. increased 1.0% in September, following a 0.4% gain in August, and a 1.0% rise in July. Says an economist at The Conference Board: “The LEI has risen for six consecutive months and the coincident economic index has increased in two of the last three months. These numbers strongly suggest that a recovery is developing. However, the intensity of that recovery will depend on how much, and how soon, demand picks up.”

M&A Activity Outlook

- **Divestitures are back in vogue as a desirable corporate strategy—and 2010 may see a wave of activity.** For companies seeking to raise capital, divesting non-core assets makes strong business sense. Divestitures, a.k.a. “spinoffs,” can generate cash to retire debt or shore up pension plans—or to make strategic acquisitions that **better fit** long-term plans. Private equity dealmakers looking to purchase businesses that are **good values** perceive that corporate spinoffs can be highly attractive. Also, private equity dealmakers who have portfolio companies to sell see corporate buyers in allied industries as prime target buyers due to perceived **synergies**.
- While distressed investments have dominated the deal landscape in 2009, “**healthy**” companies have recently begun to re-enter the market; however, many of those deals won’t close until 2010—so Q4 2009 may be quiet.
- Private sector middle market M&A activity seems poised for a rebound beginning in the second quarter of 2010, once 2009 audits have been completed, due to a **convergence of factors** (i.e., a pent-up supply of deals along with strong demand from strategic and—particularly—financial buyers). In addition, the **broader trends** that drive corporate merger activity—**globalization, pursuit of efficiencies, and a need for growth**—still hold.
- Bright spots are likely to include sectors least affected by the downturn in the economy (such as health care and **consumer staples**) and some that don’t emphasize leverage (energy). In early 2010, as Christmas 2009 sales figures come in, we could see another wave of M&A deals involving **distressed retail businesses**. M&A activity may also pick up for distressed catalogs and better performing internet companies. Likewise, next year could see more M&A deals in the **consumer discretionary** sector.

Concluding Remarks

- The current economy has certainly created **significant challenges**; however, the same factors that adversely affect corporate growth—restricted access to capital, declining market values, and intense pricing pressure—**ironically** make this moment in history one of **great opportunity**.
- Good businesses will be looking to grow by focusing on fundamentals, reinventing their models, controlling costs, and focusing on cash generation. These companies will be in the best position to negotiate a good deal on any corporate bargains available as economic conditions improve.

Sources: Thomson Reuters, Capital IQ, BusinessWeek, The Deal LLC, ADP National Employment Report, Tully & Holland, The Conference Board, Federal Housing Finance Agency, US Bureau of Labor Statistics, RiskCenter, MarketWatch, SeaFax, The Capital Roundtable, The Alliance of Merger & Acquisition Advisors® (AM&AA), The New York Times, The Wall Street Journal, Private Equity Professional Digest, Harris Williams, KPMG International, and AT Kearney.

Don O'Connor
Managing Director
781.239.2900 x12
doconnor@tullyandholland.com

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60 William St.
Suite 100
Wellesley, MA 02481
tullyandholland.com