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CONTENTS

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Market Observations as of July 21, 2009

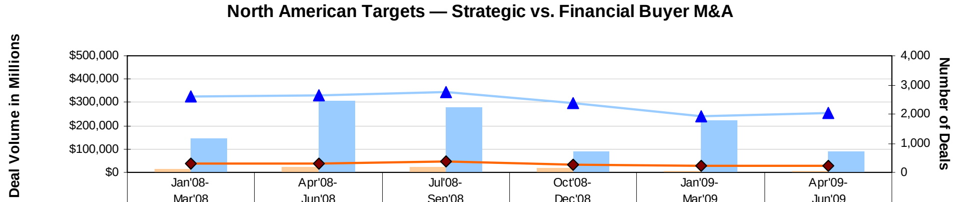
Q2 2009 M&A and Capital Markets – Global Activity

- **M&A** — announced volume $941bln in H1 2009, down 40.2% vs. H1 2008:
  - Lowest 1st half volume since 2004.
  - Financial sponsor M&A activity at a dramatic 12-year low of $32.9bln, just 3.5% of global M&A volume.
- **Equity Markets** — Modest uptick in IPO activity in Q2 vs. Q1:
  - Increased activity in China and Brazil.
  - Most significant venture-backed exit activity in the U.S. in 12 months.
- **Debt Markets** — $3.2 trillion in underwriting activity in H1**:**
  - Many qualifying institutions taking advantage of government-guaranteed debt programs.
  - Asset-backed & mortgage-backed securities, including collateralized debt obligations, declined 50%.
  - High yield corporate bond issuance increased year-over-year by 96% and had its strongest quarter since Q2 2007 as credit conditions have eased.
- **Overall Status/Outlook** — Global financial crisis fallout continues to depress market activity:
  - Particularly in M&A.
  - However, Q2 provides **some cause for optimism** because it saw the aforementioned **heightened capital markets activity**, which historically has been **a precursor for a recovery in M&A activity**.

M&A Activity by Quarter – North American Targets

- In the first half of 2009, M&A volume involving North American targets was $317.3 billion, down 35% from the first six months of 2008. M&A activity would look even worse if not for a couple blockbuster deals in the pharmaceutical industry. Pfizer is buying Wyeth for $68.1 billion, while Merck is acquiring Schering-Plough for $45.9 billion—the two biggest deals in the U.S. in 2009. There have also been big deals sparked by companies' economic difficulties, such as Chrysler's sale to Fiat.

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



	Jan'08-Mar'08	Apr'08-Jun'08	Jul'08-Sep'08	Oct'08-Dec'08	Jan'09-Mar'09	Apr'09-Jun'09
LBO $	$12,661	$25,684	$22,516	$19,227	$3,942	$3,725
Strategic $	$144,564	$304,925	$278,128	$88,698	$220,355	$89,230
LBO #	298	320	361	265	212	224
Strategic #	2,622	2,623	2,764	2,362	1,936	2,035

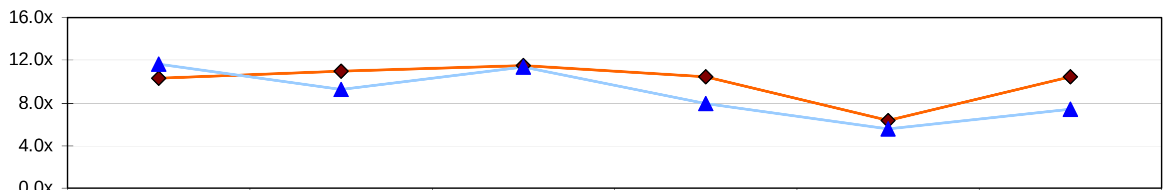
Source: Capital IQ

- But outside of a few industries, M&A volume slowed dramatically in late 2008 and early 2009. The problems for the M&A market are the same ones afflicting the world economy. Because of problems in the credit markets, private equity firms can't borrow enough to complete deals. Many strategic buyers are currently too worried about their own financial situation to consider buying a competitor, even if the price is cheap.

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 the second half of the year in many industries. First, buyers need financing. We're only now seeing 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



	Jan'08-Mar'08	Apr'08-Jun'08	Jul'08-Sep'08	Oct'08-Dec'08	Jan'09-Mar'09	Apr'09-Jun'09
LBO	10.3x	11.0x	11.5x	10.4x	6.4x	10.5x
Strategic	11.6x	9.2x	11.4x	8.0x	5.6x	7.4x

Source: Capital IQ

- The stock market rallied from March to June on hopes the economy had stopped its slide and corporate profits had begun to stabilize. But a worse-than-expected report on the June labor market report 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. For all of the pain, private equity firms that can pull off acquisitions might look back at 2008 and 2009 (and presumably 2010 too), with their cheap valuations, as signature vintages for buyouts.

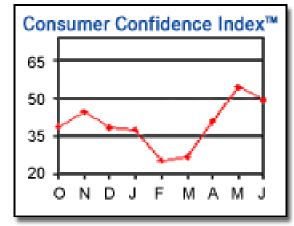
- There has been a widespread sense of a contraction in middle market deal activity since the upheaval in the capital markets hit last fall. Based on reported private equity-sponsored middle-market M&A transaction activity, the past two years cleaves fairly easily into five periods with distinct characteristics, reflecting the peak and descent of the M&A markets.

	1st Half 2007	2nd Half 2007	1st Half 2008	Q3 2008	Q4 2008/ Q1 2009
TEV/EBITDA	6.2x	5.8x	5.6x	6.2x	5.9x
Completed Deals	83	74	54	30	34
Avg. Deals/Quarter	41.5	37	27	30	17
Total Debt/EBITDA	3.8x	3.4x	3.4x	3.4x	2.5x
Sr. Debt/EBITDA	3.0x	2.6x	2.5x	2.6x	1.8x

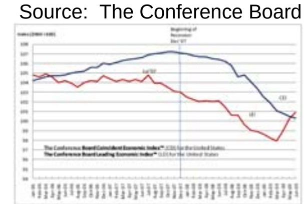
Source: GF Data Resources

- During the fourth quarter 2008/first quarter 2009 – following the capital market meltdown in September 2008, private equity-sponsored middle-market M&A registered nearly a full turn drop in debt levels, but continued resilience in average valuations as a smaller group of quality sellers were able to resist major discounts.

Economic Recovery in Sight ?



Source: The Conference Board



- Economic data says "not yet" as U.S GDP data show continued contraction.
- Some signs that the economy is stabilizing as U.S. durable and factory goods on the rise.
- Real estate showing some movement but mortgage rates rise sharply after steep drop.
- World Bank sees further global contraction
- U.S. unemployment rate still high at 9.4% in May 2009 and 9.5% in June 2009.
- Gasoline prices rose sharply in June, but inflation remains in check.
- U.S. consumer confidence down after two months of gains.
- The stimulus program is stimulating savings, not spending.
- The Conference Board Leading Economic Index™ (LEI) for the U.S. increased 0.7% in June, following a 1.3% gain in May, and a 1.0% rise in April. Over the past six months, the U.S. LEI has improved 4.1% (annual rate). The coincident economic index is still declining, but the declines are less intense. Says The Conference Board's economist: "The recession has been losing steam since the spring, although very large job losses continue. Nevertheless, confidence is slowly rebuilding. Financial markets are less volatile. Even the housing market is stabilizing. If these trends continue, expect a slow recovery this autumn."
- According to many news sources, the economy may indeed be stabilizing, but we are still far from recovery as economic data continues to be negative. We did not get into this mess overnight and it will take a long time to get back on solid footing. The U.S. economy dipped at a revised 5.5% pace in the first 3 months of 2009, still feeling the effects of the recession. GDP (Gross Domestic Product) while still down sharply was better than the -6.1% forecasted. Businesses have dramatically cut back spending.

M&A Activity Outlook

Bearish point of view: Should current gloomy economic conditions continue and financing remain limited, M&A activity over the next six to 12 months will be on the light side with a few silver linings. The deal landscape will be dominated by distressed investments across sectors including financial services, automotive, consumer (durable/discretionary) products, and retail.

- For most industries, strategic M&A has historically been correlated with favorable economic conditions. The same seems to be true of private equity deals. Bernstein Research projects that the drop-off in M&A activity will accelerate in 2009 and won't bottom out until 2010. They project that total M&A volume, including private equity and strategic deals, will decline by 25% in 2009 from the previous year, followed by a 15% year-over-year decline in 2010. This implies that the trough of the M&A market will be in the second half of 2010 and will mark a 45% decline from the peak 2007 levels.
- Even though many potentially acquisitive companies have plentiful cash reserves, cautious directors are reluctant to undertake deals for the simple reason that the economic situation could get worse.

Bullish point of view: Middle-market M&A deal flow is poised for a rebound over the next six to 12 months due to a convergence of factors (i.e., a pent-up supply of deals along with strong demand from strategic and – particularly – financial buyers).

- Optimists say the broader trends that drive corporate merger activity — globalization, pursuit of efficiencies, and a need for growth — still hold. Also, M&A activity is still hot in some sectors where there isn't a lot of emphasis put on leverage — like energy. In addition, industries such as health care, which are not affected by the downturn in the economy, should continue to be a source of deals. And it could have been worse. The projected 45% decline cited above for this cycle is nowhere near as steep as the one that occurred in the last downturn from 2000 to 2003, after the tech bubble burst. Back then, M&A activity saw a peak-to-trough decline of 70%.

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M&A Activity Outlook (cont'd.) and Concluding Remarks

- Though overall/megabuyout deal volume has fallen off a cliff, mid-market transactions are getting done, and 2008-2010 may become great "vintage" years for investors and acquirers who closed deals before the inevitable recovery begins.

Conclusion: The underlying health of the economy remains unclear and a subject of considerable debate. In the last two months, the capital markets have become increasingly liquid, competitive, and optimistic.

- While the sustainability of the recent improvement in the senior debt and mezzanine markets remains unclear, better terms and conditions are available to borrowers and investors now than in January through May 2009. If this trend continues – and hopefully improves – over the next six to 12 months, it should boost M&A activity.
- Many private equity investors and corporate acquirers would agree that **add-on acquisitions are a great way to take advantage of a recession**, allowing them to pursue a growth strategy for a portfolio company or a core business unit, respectively, that would not have been possible before the recession; however, many of them would acknowledge that **there are significant psychological barriers to investing in a downturn**.
- **Even in recessions, exit strategies need to be kept in mind.** For private equity investors, the ability to exit in a downturn boils down to two factors: Do they have a good company that's performing? Did they pay the right price for their investment? For closely-held and family-owned businesses, most sales are event-driven (i.e., an event or circumstance such as partnership problems, divorce, health, or just plain burn-out pushes the business owner into selling). Thus, a business owner would be well advised to – sooner rather than later – lay the ground work for selling, so he or she does not all of a sudden become a seller without considering the unexpected issues that almost always occur.

Sources: Thomson Reuters, Capital IQ, BusinessWeek, The Deal, GF Data Resources, Tully & Holland, SPP Capital Partners, CFO.com, SeaFax, U.S. Bureau of Labor Statistics, The Conference Board, St. Louis Fed, PricewaterhouseCoopers, Bernstein Research, Harris Williams, The New York Times, The Wall Street Journal, Middle Market Private Equity Buyouts Symposium, and V-AID Group.

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About Tully & Holland

INVESTMENT BANKING SOLUTIONS FOR CONSUMER PRODUCT COMPANIES

Tully & Holland, Inc. is a leading US investment bank that provides sophisticated corporate finance advisory services to consumer product companies with special emphasis on food companies, multi-channel marketers, consumer product manufacturers/distributors and retailers. Tully & Holland's Managing Directors have a combination of deep industry knowledge and sophisticated financial experience enabling them to craft innovative solutions for each client's needs. Founded in 1992, Tully & Holland's transaction success is facilitated by long-term relationships with financial and strategic buyers around the world.

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