BDO CAPITAL ADVISORS, LLC

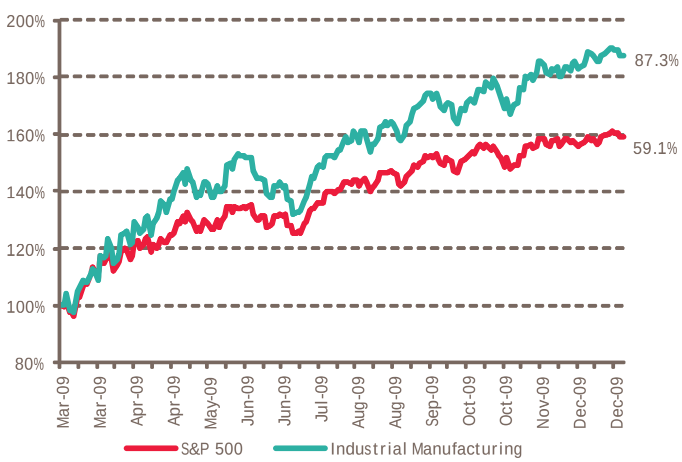
MANUFACTURING

Manufacturing Valuation Rebound or Dead Cat Bounce?

▶MANUFACTURING VALUATION REBOUND OR DEAD CAT BOUNCE?

While all of us were lamenting the credit markets, our investment portfolios and job prospects, the manufacturing industry has shown renewed life and a corresponding "above market" rebound in core valuations. Interestingly, when compared with the S&P 500, the Industrial Manufacturing index has outperformed this general market barometer. As seen below, the differential is not immaterial. Manufacturers stock market returns have exceeded those of the S&P 500 by more than 27 percentage points since March of 2009. To properly analyze the recent rebound in valuations and try to determine if it is a trend or mirage, we must examine what is driving the recent strong performance.

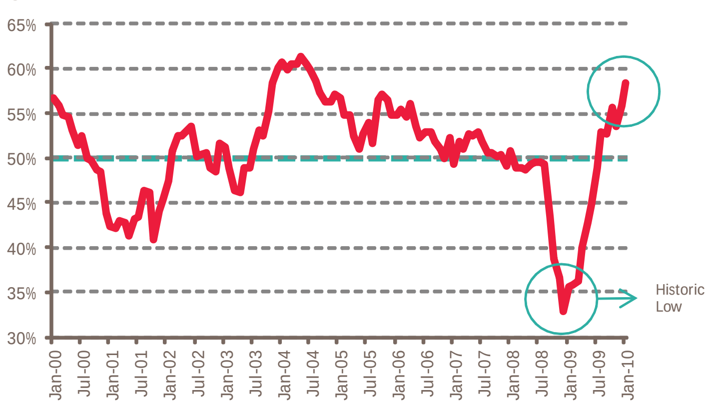
INDEX[1]



▶"IT'S THE ECONOMY----STUPID[2] "

What got us into this mess is the same thing that is turning things around—the economy. Looking at two broad economic indices that help define the health of the economy in general and industrial manufacturing in particular, we can see that since early spring, things have pointed to a rebound. The ISM manufacturing index , a leading economic indicator of industrial production and expansion and contraction of GDP, initially showed slowing declines starting in January 2009 and then in June broke through the magic 50 point level. Importantly, the January 2010 ISM manufacturing index reached 58.4, the highest level since August 2004 showing, dare we say, a manufacturing expansion trend.

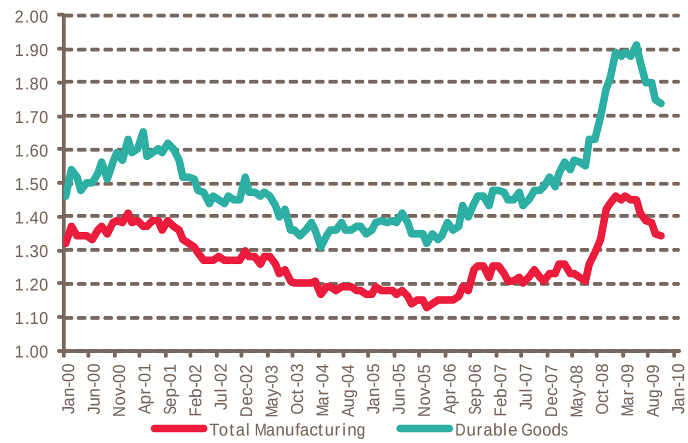
ISM INDEX[3]



Source: Institute for Supply Management

Likewise, two main inventory ratios started to move in a positive direction. In the spring of 2009, the economy started to work off its excess inventory position. Importantly, the trend continued throughout the balance of the year.

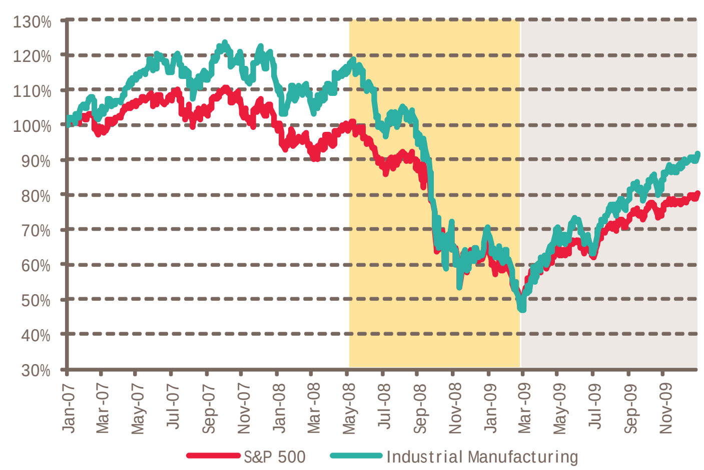
INVENTORY TO SHIPMENTS RATIO



Source: Institute for Supply Management

Not surprisingly, these and other "green shoots" had demonstrative affects on the valuations ascribed to industrial manufacturers. As seen in the chart comparing valuations for the industrial manufacturing industry with broader valuations of the S&P 500, we can see that in the yellow time zone, economic contraction, industrial manufacturers are more prone to accelerated valuation declines. During environments of, or even prospects for expansions, the industrial manufacturing sector will "outperform" the S&P as a whole in terms of value as seen in gray.

S&P 500 VS. INDUSTRIAL MANUFACTURING: 2007- 2009



[1] Index includes industrial manufacturers: A, AGCO, AME, AOS, ATK, ATU, B, BA, BDC, BEAV, BRC, CAM, CAT, CBE, CLC, CMI, CNH, CR, CSL, CUB, CW, DCI, DCO, DE, DHR, DOV, EMR, ESL, ETN, FLIR, FLS, GD, GGG, GLW, GR, HEI, HON, HUB.B, HXL, IR, ITW, KDN, KMT, LECO, LII, MMM, MOLX, MTW, NOC, PCP, PH, PLL, PNR, RBC, RBN, ROCK, ROK, ROP, RTN, SPW, SXI, TDG, TDY, TEL, TEX, TNB, TNL, TXT, TYC, URS, UTX, WTS

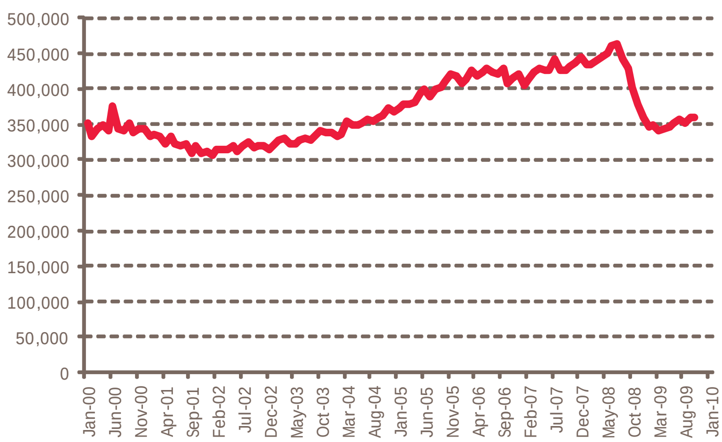
[2] Democratic consult-advisor, James Carville, advice to then candidate Bill Clinton on what to focus on and make a priority in his run for president.

[3] The ISM Index is a monthly composite index released by the Institute for Supply Management, based on a survey of more than 300 purchasing managers in the US. The index is comprised of nine sub-indices including new orders, production, supplier delivery times, backlogs, inventories, prices, employment, export orders, and import orders. An index of <50 indicates contraction; 50 indicates neutrality and >50 indicates expansion.

▶WHILE TRENDING TOWARDS "ALL WELL AND GOOD", ARE WE TOTALLY OUT OF THE WOODS YET?

The answer is an unequivocal no. As seen in the inventory to shipments ratios on the previous page, the economy still has a way to go to work out of its excessive product position. Further, total new orders, as seen below, while having fallen dramatically, have only shown a leveling off or very modest upturn. While a long way from home, some of the macroeconomic indicators are, however, positive. These optimistic signs have sparked renewed thoughts and strategy discussions for those parties interested in exploring a sale, leveraged recapitalization or similar liquidity event.

TOTAL NEW ORDERS

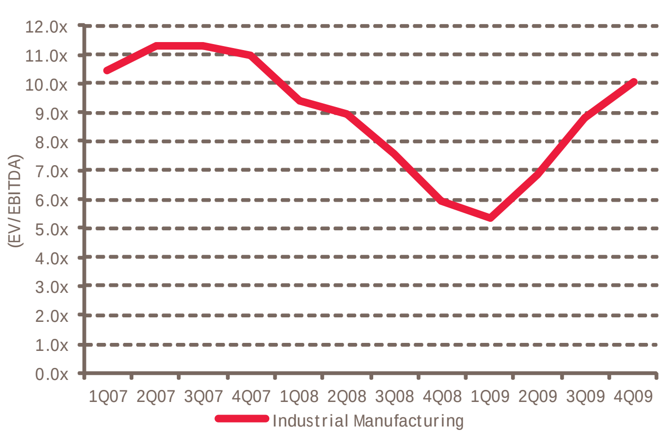


Source: U.S. Federal Reserve Board

▶VALUATIONS

While the economy appears headed in the correct direction, probably the most important indicator that portends renewed M&A activity in the industrial manufacturing industry is the strong uptick in valuations. Industrial manufacturing valuations showed a precipitous decline in mid-2008 and early 2009. A "sustained rally" has however, ensued since then. As seen in the information below, industrial manufacturing valuations, defined as multiples of cash flows or EBITDA for all of the industrial manufacturing companies in our index reached their high of 11.3x in Q2 of 2007 only to fall to their recession ravaged lows of 5.4x during late Q1 of 2009.

INDUSTRIAL MANUFACTURING INDEX VALUATION: 2007 - 2009*

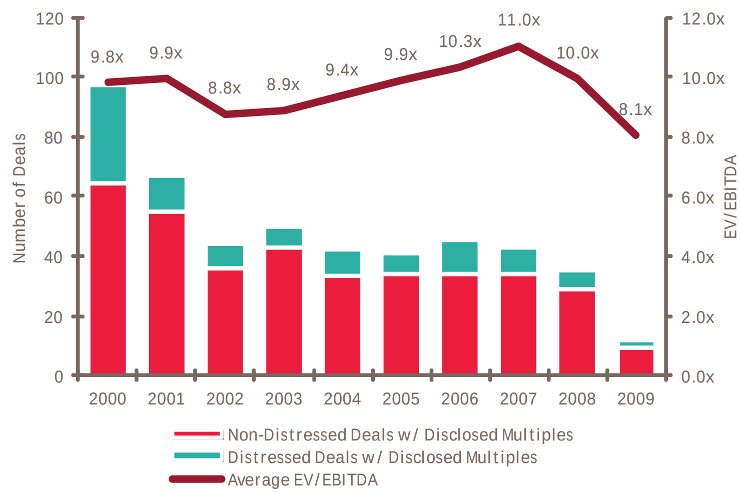


* Includes average EV/EBITDA multiples <20x

Exhibiting a strong recovery, the broad large cap, public comparable company index valuation is now trading at 10.0x its EBITDA multiple and at or near its 52 week valuation highs. Obviously, extrapolating a valuation for a closely held middle market company from this data can be difficult as appropriate size and other discounts should be taken into account. However, the directional nature of the valuation data is both relevant and telling.

While a market index, even if it is only directional in nature, is a good proxy for valuation, it is equally important to examine valuations driven by actual transactions in the industrial manufacturing industry. The data below is somewhat revealing. When we factor out distressed sales, one can see that the valuation apex occurred as one might expect in 2007. While off, the valuations for non-distressed industrial manufactures are still fairly healthy registering a respectable 8.1x multiple.

INDUSTRIAL MANUFACTURING DEAL MULTIPLES*



Source: Capital IQ

Valuations have rebounded. While not at 2007 levels there is now at least renewed interest from both buyers and sellers to see if a transaction can occur. While anecdotal in nature, we at BDO Capital are seeing inbound calls from strategic and financial buyers alike interested in looking at our client list. Barring a double dip recession or another like economic shock, both the number of transactions and sale multiples should continue to move in the correct direction.

We at BDO Capital have a long background of assisting owners of middle market industrial manufacturing companies in exploring their strategic liquidity alternatives. We would welcome the opportunity to assist you in these or other capital markets needs.

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ABOUT BDO CAPITAL ADVISORS, LLC

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